EXHIBIT 1

EXHIBIT
NUMBER 3

Municipal Secondary Market Disclosure Information Cover Sheet
Municipal Securities Rulemaking Board (MSRB)
Electronic Municipal Market Access System (EMMA)

IF THIS FILING RELATES TO A SINGLE BOND ISSUE:

Name of bond issue exactly as it appears on the cover of the Official Statement:

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Nine-digit CUSIP* numbers if available, to which the information relates:

____

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IF THIS FILING RELATES TO ALL OR SEVERAL SECURITIES ISSUED BY THE ISSUER, OR ALL OR SEVERAL SECURITIES OF A SPECIFIC CREDITOR:

Issuer's Name: **Employees Retirement System of the Government of the Commonwealth of Puerto Rico**

Other Obligated Person's Name (if any): ______________________________

Six-digit CUSIP* number(s): **29216M**

TYPE OF INFORMATION PROVIDED:

A. ☐ **Annual Financial Information and Operating Data pursuant to Rule 15c2-12**

Fiscal Period Covered: ______________________________

B. ☒ **Audited Financial Statements or CAFR pursuant to Rule 15c2-12**

Fiscal Period Covered: **2013-2014**

C. ☐ **Notice of Failure to Provide Annual Financial Information as Required:** ______________________________

Dated: June 2, 2016

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information

June 30, 2014

(With Independent Auditors' Report Thereon)

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

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KPMG

KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

The Board of Trustees
Employees' Retirement System of
the Government of the Commonwealth of Puerto Rico:

We have audited the accompanying financial statements of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the System), which comprise the statement of fiduciary net position as of June 30, 2014, the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, which collectively comprise the System's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico as of June 30, 2014, and the changes in its fiduciary net position for the year then ended, in accordance with U.S. generally accepted accounting principles.

KPMG

Emphasis of Matters

Adoption of New Accounting Pronouncements

As discussed in note 2(i) to the basic financial statements, the System adopted Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities,* effective for periods beginning after July 1, 2012. The System also adopted GASB Statement No. 67, *Financial Reporting for Pension Plans — an Amendment of GASB Statement No. 25.* Our opinion is not modified with respect to these matters.

Insolvency of the System

As discussed in note 3 to the basic financial statements, the System's fiduciary net position as a percentage of total pension liability was less than one percent as of June 30, 2014. In the opinion of management, based on information prepared by consulting actuaries, if measures are not taken to significantly increase contributions, the System will become insolvent by fiscal year 2018 depending on the timing of receipt of contributions and the System's ability to dispose of illiquid assets. Further, as described in note 10, future employers' contributions have been pledged for debt service, consequently, further depletion of System's assets could result in an inability to pay benefits. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis and the schedules included under the Required Supplementary Information in the accompanying table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

San Juan, Puerto Rico
June 1, 2016

Stamp No. E217470 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2014

(Unaudited)

Introduction

The following discussion and analysis of the financial performance of the Retirement System of the Government of the Commonwealth of Puerto Rico (the System) provides an overview of its activities for the fiscal year ended June 30, 2014. Its purpose is to provide explanations and insights into the information presented in the basic financial statements, notes to the basic financial statements, and required supplementary information. This discussion and analysis is intended to be read in conjunction with the System's financial statements.

The System is a trust created by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) in 1951 pursuant to Act No. 447 of May 15, 1951, as amended, to provide pension and other benefits to retired employees of the Commonwealth, its public corporations and municipalities of Puerto Rico.

The System administers a cost-sharing, multi-employer, pension plan (the pension plan) that consists of three benefit structures: (i) a cost-sharing, multi-employer, defined benefit program, (ii) a defined contribution program (System 2000 program), and (iii) a contributory hybrid program. The System also administers postemployment healthcare benefits provided by the Commonwealth to retired plan members.

The System is considered an integral part of the financial reporting of the Commonwealth and is included in the Commonwealth's basic financial statements.

Overview of the Basic Financial Statements

The following discussion and analysis is intended to serve as an introduction to the System's basic financial statements. The basic financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements and include the following:

- The Statement of Fiduciary Net Position – presents the financial position of the System at fiscal year end. It provides information about the nature and amounts of resources with present service capacity that the System presently controls (assets), consumption of net assets by the System that is applicable to a future reporting period (deferred outflow of resources), presents obligations to sacrifice resources that the System has little or no discretion to avoid (liabilities), and acquisition of net assets by the System that is applicable to a future reporting period (deferred inflow of resources) with the difference between assets/deferred outflow of resources and liabilities/deferred inflow of resources being reported as net position. Investments are shown at fair value. All other assets and liabilities are determined on an accrual basis.
- The Statement of Changes in Fiduciary Net Position – presents the results of activities during the fiscal year. All changes affecting the assets/deferred outflow of resources and liabilities/deferred inflow of resources of the System are reflected on an accrual basis of when the activity occurred, regardless of the timing of the related cash flows. Changes in the fair values of investments are included in the year's activity as net appreciation (depreciation) in fair value of investments.
- The Notes to the Basic Financial Statements – provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes present information about the

System's accounting policies, significant account balances and activities, material risks, obligations, contingencies, and subsequent events, if any.

- Required Supplementary Information – as required by GASB is presented after the notes to the basic financial statements. It consists of information pertaining to the System's actuarial methods and assumptions and provides data on changes in the employers' net pension liability and related ratios, the pension benefits employers' contributions, and the pension benefits' investment return as well as data on the System's other postemployment benefits.

In fiscal year 2014, the System adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB Statement No. 65). The Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement No. 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be limited to those instances identified by the GASB in authoritative pronouncements that are established after applicable due process. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement No. 4. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources and limiting the use of the term deferred in financial statement presentations. GASB Statement No. 65 requires that debt issuance costs be recognized as deduction in the period incurred in the statement of changes in fiduciary net position. At transition, the impact of GASB Statement No. 65 was to decrease the fiduciary net position as of July 1, 2012 by approximately $31,076,000 reflecting the cumulative retrospective effect of derecognizing the debt issuance costs which had previously been deferred in the statement of fiduciary net position. In addition, the issuance costs amortization of approximately $1,095,000 in fiscal year ended June 30, 2013, included as a deduction of interest on bond payable in the statement of changes in fiduciary net position, was derecognized.

In addition, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25* (GASB Statement No. 67) in fiscal year 2014. Implementation of GASB Statement No. 67 did not impact the fiduciary net position of the System; however, certain changes to note disclosures and required supplementary information have been incorporated to comply with the new standard.

Subsequent to the issuance of the System's 2013 financial statements, management of the System identified various errors in such previously issued financial statements. The System found unrecorded amounts due from the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS) resulting from net benefits paid by the System to the JRS' retirees and beneficiaries and from unallocated System's general and administrative expenses and other expenses. As a result, the System's net position restricted for pension as of July 1, 2012 was increased by approximately $12,189,000, including an estimate of approximately $4,249,000 for the lost income to be restored to the System. Additionally, the other income, the benefits paid to participants and the other expenses for the year ended June 30, 2013 were increased (decreased) by approximately $959,000; ($699,000); and $151,000, respectively, to correct these immaterial errors.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2014

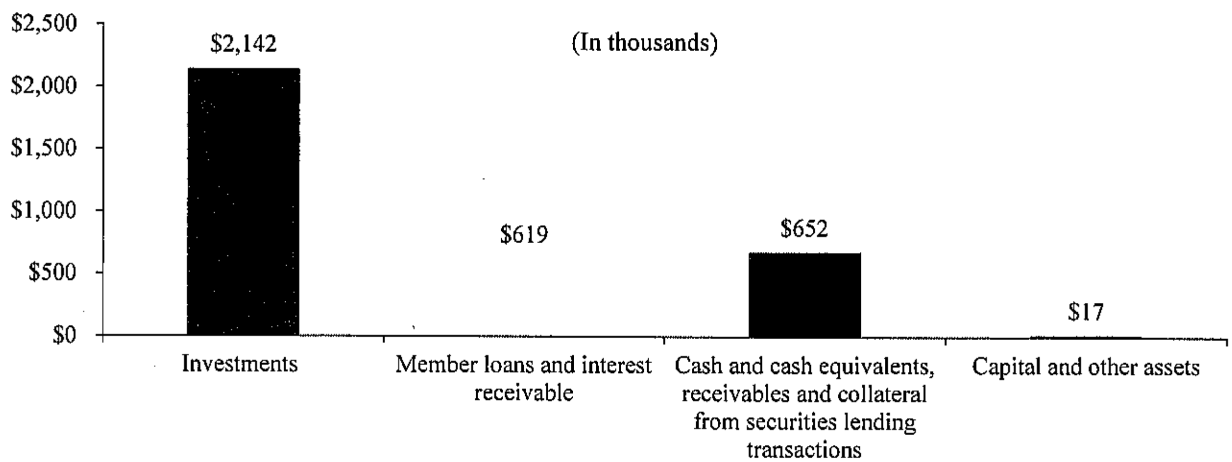
(Unaudited)

Financial Highlights

The System provides retirement benefits to employees of the Commonwealth. The System's total assets as of June 30, 2014 and 2013 amounted to $3,430 million and $3,979 million, respectively.

As of June 30, 2014, the System's total assets consisted of the following:

- $2,088 million of investments in bonds, stocks and nonexchange commingled trust funds
- $54 million in investments in limited partnerships
- $619 million in member loans and interest receivable
- $652 million in cash and cash equivalents, receivables and collateral from securities lending transactions.
- $17 million in capital and other assets



As of June 30, 2013, the System's total assets consisted of the following:

- $2,405 million of investments in bonds, stocks and nonexchange commingled trust funds
- $55 million in investments in limited partnerships
- $791 million in member loans and interest receivable
- $715 million in cash and cash equivalents, receivables and collateral from securities lending transactions
- $14 million in capital and other assets

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2014

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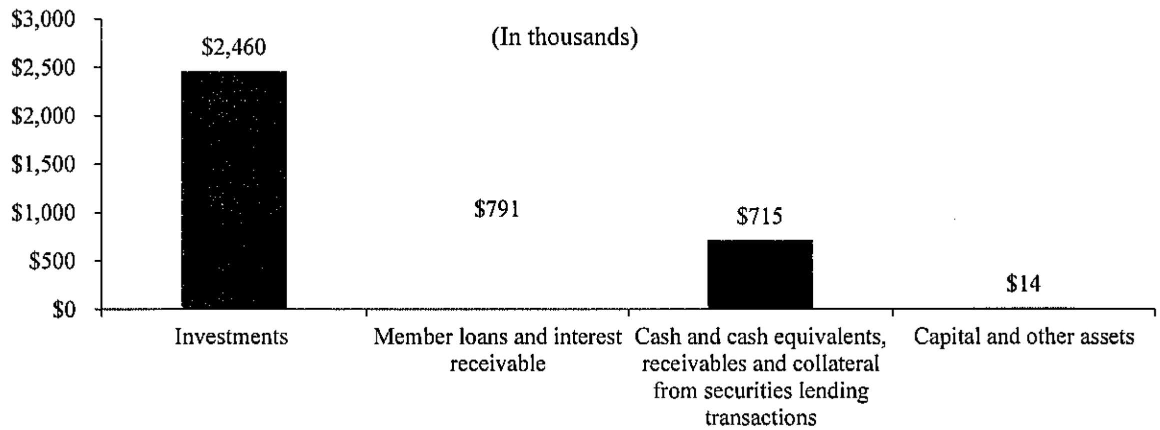

- The System's total assets exceeded total liabilities (fiduciary net position) by $81 million as of June 30, 2014, compared with fiduciary net position of $715 million as of June 30, 2013.
- Member loans and interest receivable amounted to $619 million as of June 30, 2014, compared to $791 million as of June 30, 2013.
- The plan's fiduciary net position as a percentage of the total pension liability was 0.27% at June 30, 2014.
- The medical insurance plan contribution, which constitutes the other postemployment healthcare benefits, is financed by the Commonwealth on a pay-as-you-go basis and consequently is unfunded.

(Continued)

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

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Management's Discussion and Analysis

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(Unaudited)

The following schedules present comparative summary financial statements of the System's fiduciary net position and changes in fiduciary net position for fiscal years 2014 and 2013:

Comparative Summary of Fiduciary Net Position – Pension Benefits

	2014	2013 As restated and adjusted	Total dollar change	Total percentage change
		(Dollars in thousands)		
Assets:				
Cash and cash equivalents, receivables-net and collateral from securities lending transactions	$ 652,360	714,728	(62,368)	(8.7)%
Investments	2,142,022	2,459,874	(317,852)	(12.9)
Member loans and interest receivable – net	619,379	791,161	(171,782)	(21.7)
Capital assets and other	16,906	13,855	3,051	22.0
Total assets	3,430,667	3,979,618	(548,951)	(13.8)
Liabilities:				
Accounts payable and accrued liabilities	12,236	13,905	(1,669)	(12.0)
Bond interest payable	13,876	13,876	—	—
Payable for investment securities purchased	19,009	—	19,009	100.0
Securities lending obligations	126,648	124,411	2,237	1.8
Due to Commonwealth of Puerto Rico	37,082	—	37,082	100.0
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members	7,895	7,483	412	5.5
Bonds payable	3,077,587	3,051,189	26,398	0.9
Other liabilities	55,668	53,697	1,971	3.7
Total liabilities	3,350,001	3,264,561	85,440	2.6
Net position restricted for pensions	$ 80,666	715,057	(634,391)	(88.7)%

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

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Management's Discussion and Analysis

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Comparative Summary of Changes in Fiduciary Net Position – Pension Benefits

	2014	2013 As restated and adjusted	Total dollar change	Total percentage change
	(Dollar in thousands)			
Additions:				
Contributions:				
Employer contributions:				
Basic benefits	$ 485,114	424,704	60,410	14.2%
Special benefits	228,699	203,943	24,756	12.1
Member contributions	359,862	322,528	37,334	11.6
Net investment and securities lending transactions income	225,005	245,022	(20,017)	(8.2)
Other income	30,748	22,994	7,754	33.7
Total additions	1,329,428	1,219,191	110,237	9.0
Deductions:				
Benefits paid to participants	1,548,423	1,430,013	118,410	8.3
Refunds of contributions	166,335	52,307	114,028	218.0
Interest on bonds payable	192,947	191,135	1,812	0.9
General and administrative	29,530	33,078	(3,548)	(10.7)
Other expenses	26,584	16,246	10,338	63.6
Total deductions	1,963,819	1,722,779	241,040	14.0
Decrease in net position	(634,391)	(503,588)	(130,803)	26.0%
Net position restricted for pension:				
Beginning of year	715,057	1,237,532	(522,475)	(42.2)
Adjustment of beginning of year net position	—	(18,887)	18,887	(100.0)
End of year	$ 80,666	715,057	(634,391)	(88.7)

Refer to previous section "Overview of the Basic Financial Statements" for changes in the financial statements as required by GASB Statement No. 65 and by GASB Statement No. 67, and for a correction of immaterial errors.

Insolvency of the System

The discussion in note 3 to the financial statements provides information regarding the System's liquidity risk and uncertainties. Liquidity risk is the risk of not having sufficient liquid financial resources to meet obligations when they come due.

The System's net pension liability (under the newly adopted GASB Statement No. 67) and the funded ratio as of June 30, 2014, are approximately $30,139 million and 0.27%, respectively. The System has been in a deficit position since fiscal year 2015. Based on statutory funding requirements, the annual benefit payments and administrative expenses paid by the System were significantly larger than the employee and employer contributions received by the Systems. As described in note 10 to the financial statements, future employers' contributions of the System are pledged for the payment of debt service on the System bonds. Further depletion of the System' assets could result in the inability to pay benefits and bonds.

The estimate of when the System will become insolvent and when its assets will be exhausted is based on significant assumptions, including the rate of return on investments, the amount and timing of collections from the Commonwealth for the member and employer contributions, as well as the estimated participant benefits and the System's administrative expenses to be paid each year.

If the System becomes insolvent, it would be operating solely on a "pay as you go" basis, which means that the System would be unable to pay benefits that exceed the actual employer and member contributions received (net of administrative and other expenses), unless the Commonwealth and other participating employers provide the funding required to meet the "pay as you go" required benefits.

The System's funding requirements, together with the funding requirements of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico and the Puerto Rico System of Annuities and Pensions for Teachers, could have a negative effect on the Commonwealth's General Fund, since the Commonwealth is the primary sponsor and is obligated to make contributions to fund each of the systems.

The Commonwealth and the other participating employers have been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations.

If the Commonwealth's financial condition does not improve as a result of fiscal and budgetary measures it is taking, its ability to repay its obligations, including its regular employer contributions to the System and its additional contribution as provided by Act No. 32 of 2013 (Act No. 32), for the upcoming years, may continue to be adversely affected, and could also affect the payment of benefits and the repayment of the System's bond payable.

Comparative Summary of Fiduciary Net Position Analysis – Pension Benefits

The basic financial statements of the System for the fiscal year ended June 30, 2014, present a decrease in net position restricted for pensions of approximately $634 million or 88.7%, when compared to the prior fiscal year which resulted from the excess of deductions, mainly benefits paid to participants, over additions, mainly contributions from participating employers and employees. The decrease in net position mainly caused a decrease in loans and interest receivable from plan members of $172 million and a decrease in investments of $318 million. The Board of Trustees approved the sale of personal loans. During the years ended June 30, 2014 and 2013, personal loans with principal balances amounting to approximately $100 million and $88 million, respectively, were sold to two financial institutions.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO
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Total contributions from participating employers and members increased by approximately $123 million, from $951 million during fiscal year 2013 to $1,074 million during fiscal year 2014. The System recognized a net appreciation in the fair value of investments of $125 million during 2014, which represents an increase of $4 million from the net appreciation of $121 million recognized in 2013.

Total deductions increased by $241 million in fiscal year 2014, mainly as a result of the increase of $118 million in benefits paid to participants and the increase of $114 million in the refunds of contributions paid to participating employees who resigned mainly as a result of implementation of Act No. 3 of 2013 (Act No. 3). Benefits paid to participants amounted to $1,548 million for the fiscal year 2014 and $1,430 million for the fiscal year 2013.

During fiscal year 2007, the Board of Trustees approved the issuance of bonds payable to increase the funds available to pay pension benefits to certain beneficiaries and to reduce the unfunded accrued actuarial liability. As of June 30, 2014, bonds payable amounted to $3,078 million.

Other Postemployment Healthcare Benefits

Other postemployment healthcare benefits paid during the fiscal year 2014 amounted to $102 million, an increase of 11% when compared to the $92 million paid during fiscal year 2013.

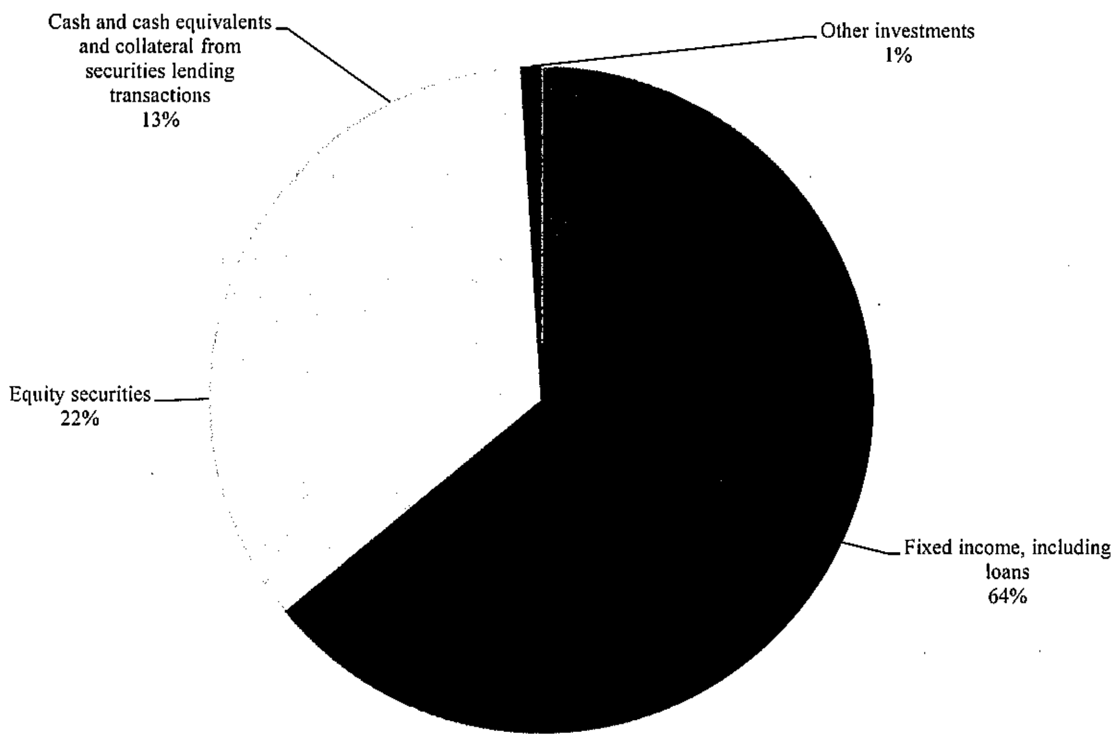
Financial Analysis of the System

As of June 30, 2014 and 2013, the System held approximately $619 million and $791 million, respectively, in loans and interest receivable from plan members, which represents 22% and 24%, respectively, of the total investment portfolio, including loans. As of June 30, 2014, member loans and interest receivable consisted of $164 million in mortgage loans, $374 million in personal loans, $45 million in cultural trips loans, and $40 million in interest receivable, less $4 million in allowance for adjustments and losses in realization. As of June 30, 2013, member loans and interest receivable consisted of $160 million in mortgage loans, $528 million in personal loans, $68 million in cultural trips loans, and $40 million in interest receivable, less $5 million in allowance for adjustment and losses in realization. As of June 30, 2014 and 2013, the fair value of the System's investment in limited partnerships amounted to $54 and $55 million, respectively, which represented approximately 3% of the investment portfolio, as of June 30, 2014 and 2013.

The System earns additional investment income by lending investment securities to brokers via its custodian's securities lending program. The brokers provide collateral to the System and generally use the borrowed securities to cover short sales and failed trades. The cash collateral received from the brokers is invested in a short-term investment fund in order to earn interest. For the years ended June 30, 2014 and 2013, net income from the securities lending activity amounted to approximately $298,000 and $115,000, respectively.

Investment Portfolio and Capital Markets Overview

As of June 30, 2014, the System's asset allocation was 64% in fixed-income investments, including loans receivable, 22% in equity securities, 13% in cash and short-term investments, and 1% in other investments as shown in the following chart:



Economy and Capital Markets Overview

The beginning of the 2014 Fiscal Year was rewarding for investors as the Dow Jones U.S. Total Stock Market Index hit a new all-time high in September 2013, and international equities soared as Europe emerged from its recession. Equity valuations continued to be driven by external forces during the first quarter of the fiscal year, including continued loose monetary policy and congressional gridlock in Washington due to debates over the Affordable Care Act, the debt ceiling limit, and the lead up to the first government shutdown since 1995-1996. In September 2013, the Federal Open Market Committee (FOMC) surprised investors with the decision to not taper its $85 billion in monthly bond purchases. Meanwhile, in Europe, disappointing economic growth numbers, coupled with very low inflation rates prompted the European Central Bank (ECB) to cut their main policy interest

rate from an ultra-low 0.50% to 0.25%. On the eve of the New Year, equity markets continued to rise as the S&P 500 reached an all-time high. The end of 2013 also marked the end of Ben Bernanke's tenure as the Federal Reserve Chairman; Janet Yellen was nominated to succeed Mr. Bernanke. Additionally, the FOMC finally announced that it would begin to taper the rate of Treasury and mortgage-backed securities purchases by $10 billion and that it intended to do so throughout 2014. As a result, the 10-Year Treasury yield rose to a period high of 3.0% to close the year and drove fixed income market returns into negative territory.

Moving into the second half of the fiscal year, global equity markets struggled as unusually harsh winter weather was blamed for disappointing economic data in the US. Political turmoil in Ukraine and Turkey, coupled with weak economic data from China, triggered a sell-off in emerging markets. The economic uncertainty around the globe prompted a "risk-off" environment during the first quarter of 2014 and resulted in a flight to quality into US Treasuries, driving long yields lower. However, new Fed Chairman, Janet Yellen, commented that a rise in the policy rate may occur as soon as six months following the end of Quantitative Easing which led short term rates higher. The fiscal year ended on a more positive note as both equity and fixed income markets experienced positive returns bolstered by improvement in US economic data, easing tensions in Ukraine, and monetary easing in Europe. Overseas, the European Central Bank further loosened its monetary policy stance and proposed a series of measures to avoid deflationary pressures in the Euro Zone. In Japan, while no further policy measures were seen, the government proposed plans to combat the continuing risk of deflation and to revitalize the Japanese economy. In addition, conditions in emerging markets overall improved as investor attention seemed to have moved past the political turmoil between Russia and Ukraine. Bond markets were also buoyed by the Fed's firm commitment to keep policy interest rates very low for an extended period beyond the end of 2015.

With continued support from the Fed and mostly positive economic news, domestic equity markets trended upwards throughout the fiscal year, returning 25.0%. Developed international markets posted a 23.6% return supported by monetary easing by the ECB. Emerging markets trailed the broader market, returning 14.3%, as confrontation escalated in Ukraine and continuing concerns regarding China's growth prospects weighed on performance. The broad U.S. fixed income market experienced modest performance relative to equity markets and returned 4.4% during the period. The yield on the 10-Year U.S. Treasury ended the fiscal year roughly where it began at 2.5% after declining from its peak of 3.0% following the FOMC's decision to begin tapering its quantitative easing program.

Industry Indices Performance Overview

Total Fund Performance

The System's total investments, including member loans, returned 11.2% during the 2014 Fiscal Year, underperforming its policy benchmark by 0.11 percentage points. The System's total assets, including member loans and operational cash, as of June 30, 2014 totaled $3,430 million.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2014

(Unaudited)

The table below shows the System's asset allocation at the end of the 2014 Fiscal Year.

Indices	FY 2013-14	First quarter FY 2014	Second quarter FY 2014	Third quarter FY 2014	Fourth quarter FY 2014
Dow Jones United States	25.0%	6.2%	10.1%	2.0%	4.8%
S&P 500	24.6	5.2	10.5	1.8	5.2
S&P/Citigroup Large Growth	27.1	6.6	11.1	1.4	5.8
S&P/Citigroup Large Value	22.0	3.8	9.8	2.3	4.6
Russell 3000	25.2	6.3	10.1	2.0	4.9
Russell 2000 Index	23.6	10.2	8.7	1.1	2.0
Russell 2000 Growth	24.7	12.8	8.2	0.5	1.7
Russell 2000 Value	22.5	7.6	9.3	1.8	2.4
MSCI ACW ex-U.S.	21.8	10.1	4.8	0.5	5.0
MSCI EAFE	23.6	11.6	5.7	0.7	4.1
MSCI Emerging Markets	14.3	5.8	1.8	(0.4)	6.6
Barclays Aggregate Bond Index	4.4	0.6	(0.1)	1.8	2.0
Barclays Intermediate Credit	5.2	1.0	0.7	1.6	1.8

The System's total investments, excluding member loans, generated a return of 11.9% during the 2013-2014 fiscal year, outperforming its policy benchmark by 0.6 percentage points. Outperformance was primarily a result of being overweight United States and international equities relative to the long-term target weights as equities overall outperformed fixed income. The overweight allocation to equities was a consequence of the System gradually de-risking its investment program (shifting from equities into bonds). This transition was concluded at the end of the fiscal year. The System's total investments, excluding member loans as of June 30, 2014 totaled $2,142 million.

United States Equity Overview for the Fiscal Year 2014

U.S. stocks as measured by the Dow Jones U.S. Total Stock Market Index gained 25.0% during the fiscal year. All sectors produced positive returns during the fiscal year led by information technology and materials, which were the top performing sectors. From a style perspective, growth stocks outpaced value stocks across large and small cap markets, while value stocks bested growth in the mid cap space. On a capitalization basis, mid cap stocks were the best performers during the period, followed by large and small cap stocks.

The System's domestic equity component returned 24.9% during the fiscal year, underperforming its benchmark, the Russell 3000 Index Fund, by 0.3 percentage points. Underperformance was due to the impact of cash flow timing and withdrawals. The Russell 3000 Index Fund matched its benchmark during the period. Approximately $275.0 million was redeemed from the domestic equity component during the fiscal year in order to meet the cash needs of the System. As of June 30, 2014, the System's domestic equity assets totaled $513.6 million and represented approximately 16.9% of the System's total assets, including loans and operational cash.

International Equity Overview for the Fiscal Year 2014

International equities, as measured by the MSCI ACW ex-U.S. Index, gained 21.8%. The index posted positive returns for four consecutive quarters as monetary easing from the ECB provided support. Europe ex-U.K. and the U.K. were the strongest performing regions over the fiscal year.

During the fiscal year, the System's international equity component gained 21.0%, trailing its benchmark by 0.8 percentage points. Underperformance was due to the impact of cash flow timing and withdrawals made. The SSgA ACW ex-U.S. Index Fund experienced modest positive tracking error during the period. Approximately $85.0 million was redeemed from the component during the fiscal year in order to meet the cash needs of the System. At the end of the fiscal year, the component had $167.9 million in assets, representing 5.5% of the System's total assets, including loans and operational cash.

The U.S. fixed income market, as measured by the Barclays Aggregate Bond Index, produced positive results in three of four quarters returning 4.4% in the fiscal year. The Barclays Intermediate Credit Index, the System's benchmark for its fixed income portfolio, outperformed the broader U.S. fixed income market gaining 5.2%. All underlying sectors generated positive returns during the period, with the corporate bond sector providing the strongest returns followed by the mortgage-backed securities and commercial mortgage-backed securities sectors. Long duration bonds outperformed shorter duration bonds while lower quality maturities outpaced those of higher quality.

The System's fixed income component gained 5.1% during the one year period ending June 30, 2014, outperforming its benchmark by 0.2 percentage points. Taplin, Canida, & Habacht, Santander, and Mesirow contributed to performance, while Chicago Equity Partners, Popular, and Barrow Hanley detracted from results. The SSGA Intermediate Credit Index Fund had modest negative tracking error. At the end of the fiscal year, fixed income assets totaled $1,309.8 million, consisting of approximately 43.2% of the System's total assets, including loans and operational cash. Approximately $157.0 million was redeemed from the component during the fiscal year in order to meet the cash needs of the System. (Additional information on the transactions can be found under the Other Investments and Transactions section of this memorandum).

Other Investments and Member Loans Transactions

As of June 30, 2014, the System held $619 million in member loans which represented 18.1% of the total portfolio's assets, including loans and operational cash. Member loan balances as of June 30, 2014 were $172 million lower than a year ago.

At the end of the 2014 Fiscal Year, the System had some exposure to limited partnerships of private equity investments valued at approximately $54 million, which represented 1.6% of the System's total assets, including member loans and operational cash.

In order to meet the cash needs of the System, the following transactions occurred during the 2014 Fiscal Year:

- $170.0 million, $85.0 million, and $20.0 million were redeemed from the SSGA Russell 3000 Index, SSGA ACW ex-U.S. Index, and SSGA Intermediate Credit Index Funds, respectively, in November.

- $40.0 million and $25.0 million were redeemed from the SSGA Intermediate Credit Index Fund and Mesirow, respectively, in December 2013.
- $105.0 million and $72.0 million were redeemed from the SSGA Russell 3000 Index and SSGA Intermediate Credit Index Funds, respectively, in May 2014.
- $35.0 million was transferred from the SSGA ACW ex-U.S. Index Fund to the SSGA Russell 3000 Index Fund for rebalancing purposes to better align allocations to long-term policy target weights.
- $100 million member loans were sold to two financial institutions.

Funding Status

The System was created by Act No. 447 of May 15, 1951 (Act No. 447) and, since its inception, lacked proper planning. The levels of contributions were relatively low and still remain low in comparison to the level of benefits. In addition, all retirement systems in place before 1951 were merged into the System, which then had to absorb all of their unfunded liabilities. Afterwards, in 1973, the benefits structure was enhanced without the appropriate increase in contribution levels. As more people joined the government labor force and then retired under the new enhanced benefit structure, the gap between the assets available to pay benefits and the actuarial obligation started its steeping course.

In 1990, in an effort to withstand the increase in the unfunded liability, the benefit structure was modified to decrease the benefits and to postpone the retirement age from 55 to 65, in order to provide a more affordable benefit structure. Also, the level of contributions was raised and Act No. 447 was amended to provide that any increase in benefits would require actuarial studies and identification of the financing source.

Ten years later, the continuing increase in the unfunded liability required further action. As a result, the original defined benefit structure was closed to new plan members joining the System on or after January 1, 2000. To provide a retirement alternative, the pension benefit structure was further amended by Act No. 305 of September 24, 1999 (Act No. 305) to provide for a cash balance program, similar to a cash balance plan, to be funded only by participating employees' contributions. That program is known as the Retirement Savings Account Program (System 2000). Under System 2000, the employers' contributions continue at the same level as the original defined benefit structure, but are being used to fund the accrued actuarial liability of the original defined benefit structure that was closed. Also under System 2000, the disability benefits are to be provided through a private insurance long term disability program to those plan members that voluntarily elect to enroll in such program. On September 15, 2004, Act No. 296 was enacted to amend the dispositions of Act No. 305 regarding disbursements and the disability benefits program. After the amendment, any plan member that leaves public service may request that the balance in his/her savings account be transferred to a qualified retirement vehicle such as an individual retirement account or a qualified retirement plan in Puerto Rico. Act No. 296 of 2004 also provides flexibility on the establishment of the disability program; but still, the employees must finance the program.

Presently, the pension plan consists of three different benefit structures, which are administrated according to their specifications in each Act. For all plan members, excluding System 2000 participants, the level of contributions established by law is 8.275% of the employee salary. Under System 2000, employee contributions range from

8.275% to 10% of the salary, as specified by the employee. Under all structures, employers' contributions during the year ended June 30, 2014 were 12.275% of the employee salary.

On February 27, 2007, the System's administration and the Government Development Bank for Puerto Rico, acting as the System's fiscal agent, presented to the Board of Trustees a financial transaction for the issuance of pension funding bonds. The System authorized the issuance of one or more series of bonds (the Bonds) in order to increase the funds available to pay pension benefits and to reduce the unfunded accrued actuarial pension liability. The System pledged future employers' contributions to the payment of the Bonds, invested the proceeds of the Bonds, and used these investments and the earnings thereon to provide pension benefits to beneficiaries. On January 31, 2008, the System issued the first series of the Bonds, which consisted of approximately $1,589 million aggregate principal amount of Senior Pension Funding Bonds, Series A. On June 2, 2008, the System issued the second of such series of Bonds, which consisted of approximately $1,059 million aggregate principal amount of Senior Pension Funding Bonds, Series B. Finally, on June 30, 2008, the System issued the third and final of such series of Bonds, which consisted of approximately $300 million aggregate principal amount of Senior Pension Funding Bonds, Series C.

Nevertheless, the System's actuarial obligation continues its increasing trend as a result of the continuous increase in the pensioners' population and its longevity and the fact that incoming pensioners have higher salaries and consequently, they are entitled to even higher annuities. Since 1990, there have been no other increases in the employers' or participating employees' contributions to cope with those factors and, therefore, the level of contributions remains low in comparison to the level of pension benefits.

Market events, plus the continuous increase in the actuarial liability have had a negative effect over the employers' net pension liability. Based on the last actuarial valuation at June 30, 2014, the Employers' net pension liability amounted to $30,139 million, with a Plan's fiduciary net position as a percentage of the total pension liability of 0.27%. The unfunded liability for postemployment healthcare benefits amounted to approximately $1,438 million as of June 30, 2014 and was fully unfunded.

The bottom line is that the capital markets by themselves cannot solve the System's funding problem. In order to improve the System's funding ratio, the Commonwealth enacted Law 116 increasing the employers' contribution rate from 9.275% to 10.275% of employee compensation for the 2011-2012 fiscal year, 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. Other measures taken to improve the System's funding, include 1) improving the collection of late contributions by receiving such contributions directly from the Municipal Revenue Collection Center (known as CRIM by its Spanish acronym) when a municipality fails to send their contributions within 30 days from the due date or from the Department of Treasury of the Commonwealth in the case of public corporations; 2) implementation of Act No. 70 establishing early retirement incentives; 3) revision of the Employee Personal Loan Policy by reducing personal and cultural loan amounts to $5,000 each, from $15,000 and $10,000, respectively; and 4) the receipt of $162.5 million in bonds issued by the Puerto Rico Sales Tax Financing Corporation (known as COFINA by its Spanish acronym).

In 2013, the Commonwealth enacted legislation that reformed the System by, among other measures, reducing benefits, increasing employee contributions, and, in the case of active employees who were entitled to the defined

benefits program, replacing most of the defined benefit elements of the system with a defined contribution system. Based on the statutory funding requirements prior to this reform, the annual benefit payments and administrative expenses of the System were significantly larger than the member and employer contributions made to the System. The reform intended to address the Commonwealth's future cash flow needs and "pay-as-you-go" requirements, while recognizing that the System would continue to have a large unfunded actuarial accrued liability and a low funded ratio. As such, the reform was intended to provide enough cash for the System to be able to pay benefits (as amended through the reform) and debt service on the pension obligation bonds, while maintaining projected System gross assets at no less than $1 billion at all times.

In order to achieve this goal, the reform contemplated that the Commonwealth and other participating employers would have to provide additional annual funding above the statutorily prescribed contributions as required by Act No. 32. As a long-term plan, it was recognized that constant monitoring would be required to ensure that the System remained on track to meet the reform's goals. The receipt of the additional uniform contribution of Act No. 32 is critical to the System's ability to make payments as they become due.

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447, Act No. 1 of 1990 (Act No. 1) and Act No. 305 to establish, among other things, a defined contribution program similar to the System 2000 Program (the Contributory Hybrid Program) to be administered by the Retirement System. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the Defined Benefit Program and the System 2000 Program, and were rehired on or after July 1, 2013, become members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous plans will become part of the Contributory Hybrid Program. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under the Defined Benefit Program, and thereafter, all future benefits will accrue under the defined contribution formula used for the 2000 System Program participants. Ceasing future defined benefit accruals under Act No. 447 and Act No. 1 and converting to a member-funded hybrid plan will result in lower benefit payments as these tiers wind down, and will make all future employer contributions available to pay benefits and bonds payable debt service.

Capital Assets

The System's investment in capital assets as of June 30, 2014 and 2013 amounted to approximately $11 million and $9 million, respectively, net of accumulated depreciation. Capital assets include land, building and improvements, construction in progress, and equipment. Building and improvements consist of the facilities in which the System has its operations. Refer to note 9 to the basic financial statements for further information regarding the System's net capital assets.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2014

(Unaudited)

Debt Administration

Long-term debt obligations include the System's senior funding bonds and amounted to $3,078 million and $3,051 million as of June 30, 2014 and 2013, respectively. The System has issued three series of revenue bonds designated as "Senior Pension Funding Bonds", the proceeds of which have been used mainly to increase the funds currently available to pay pension benefits to certain of its beneficiaries and reduce its unfunded actuarial accrued liability. The Bonds are limited, nonrecourse obligations of the System, payable solely from and secured solely by a pledge of employer contributions made after the date of issuance of the first series of Bonds, and from funds held on deposit with the Bank of New York Mellon (the Fiscal Agent). The Bonds are not payable from contributions made to the System by participating employees, or from the assets acquired with the proceeds of the Bonds, or from employer contributions released by the Fiscal Agent to the System after funding of required reserves, or from any other assets of the System. These bonds are currently rated "Ca" by Moody's Investors Service and "CC" by Standard & Poor's Ratings Services. Refer to note 10 to the basic financial statements for further information regarding the System's long-term obligations.

Subsequent Events

On April 6, 2016, the Governor of Puerto Rico signed into law the Puerto Rico Emergency Moratorium and Rehabilitation Act ("Act No. 21"). Among other objectives, Act No. 21 allows the Governor to declare – at some point in the future – a moratorium on debt service payments and to stay related creditor remedies for a temporary period for the Commonwealth, the GDB, the Economic Development Bank for Puerto Rico, and certain additional government instrumentalities in Puerto Rico, including the System. The temporary period set forth in Act No. 21 lasts until January 31, 2017, with a possible two-month extension in the Governor's discretion. The provisions regarding the moratorium and stay in respect of any obligations owed by the System require executive action of the Governor to become effective. At this time, the Governor has not taken any executive action in respect of the System, and Act No. 21 does not currently affect the System's obligations, including to make debt service payments.

On April 8, 2016, the Governor of Puerto Rico signed an executive order, EO-2016-010 (the "Executive Order"), declaring GDB to be in a state of emergency pursuant to Act No. 21. The Executive Order, in accordance with the emergency powers provided for in Act No. 21, implemented a regulatory framework governing GDB's operations and liquidity, including establishing a procedure with respect to governmental withdrawals, payments, and transfer requests in respect of funds held on deposit at GDB and loan disbursements by GDB. The procedures implemented by the Executive Order may result in restrictions on the ability of the System to withdraw any funds held on deposit at GDB or to receive any disbursements on loans granted by GDB during the period of the Executive Order, which is in effect until June 30, 2016. However, while the Executive Order created a stay on the enforcement of certain financial debt obligations of GDB, it did not impose a moratorium on any financial debt obligation of GDB. The Executive Order did not declare an emergency period for the Commonwealth itself, the System or any other entity, other than GDB.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis

June 30, 2014

(Unaudited)

Requests for Information

The financial report is designed to provide a general overview of the System's finances, comply with related laws and regulations, and demonstrate commitment to public accountability. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Commonwealth of Puerto Rico Government Employees and Judiciary Retirement Systems Administration, 437 Ponce de León Avenue, Hato Rey, Puerto Rico 00918.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Fiduciary Net Position

June 30, 2014

(In thousands)

	Pension	Post employment healthcare benefits	Total
Assets:			
Cash and cash equivalents:			
Deposits with Government Development Bank for Puerto Rico (GDB)			
Unrestricted	$ 53,510	—	53,510
Restricted	17,998	—	17,998
Deposits with GDB held by the Puerto Rico Department of Treasury	3,470	—	3,470
Deposits at commercial banks – restricted	12,529	—	12,529
Money market funds:			
Unrestricted	64,824	—	64,824
Restricted	112,711	—	112,711
U.S. Treasury bill – restricted	4,450	—	4,450
Total cash and cash equivalents	269,492	—	269,492
Receivables, net:			
Employers – net of allowance for uncollectible accounts of $82,848	195,803	—	195,803
Due from Retirement System for the Judiciary of the Commonwealth of Puerto Rico	19,122	—	19,122
Accrued investment income	9,500	—	9,500
Investments sold	10,976	—	10,976
Other	20,819	—	20,819
Total receivables, net	256,220	—	256,220
Collateral from securities lending transactions	126,648	—	126,648
Investments:			
Bonds and notes	1,337,292	—	1,337,292
Nonexchange commingled trust funds	750,482	—	750,482
Investments in limited partnerships	54,146	—	54,146
Stocks	102	—	102
Total investments	2,142,022	—	2,142,022
Member loans and interest receivable – net	619,379	—	619,379
Capital assets – net	11,211	—	11,211
Other assets	5,695	—	5,695
Total assets	$ 3,430,667	—	3,430,667

(Continued)

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Fiduciary Net Position

June 30, 2014

(In thousands)

		Pension	Post employment healthcare benefits	Total
Liabilities:				
Accounts payable and accrued liabilities	$	12,236	—	12,236
Bond interest payable		13,876	—	13,876
Payable for investment securities purchased		19,009	—	19,009
Securities lending obligations		126,648	—	126,648
Due to Commonwealth of Puerto Rico		37,082	—	37,082
Escrow funds of mortgage loans and guarantee insurance reserve for member loans		7,895	—	7,895
Bonds payable		3,077,587	—	3,077,587
Other liabilities		55,668	—	55,668
Total liabilities		3,350,001	—	3,350,001
Contingencies (notes 2 and 15)				
Net position restricted for pensions	$	80,666	—	80,666

See accompanying notes to basic financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Changes in Fiduciary Net Position

Year ended June 30, 2014

(In thousands)

		Pension	Post employment healthcare benefits	Total
Additions:				
Contributions:				
Employer contributions:				
Basic benefits, net of provision for uncollectible contributions of $82,848	$	485,114	—	485,114
Special benefits		228,699	102,085	330,784
Member contributions		359,862	—	359,862
Total contributions		1,073,675	102,085	1,175,760
Investment income:				
Net appreciation in fair value of investments		124,907	—	124,907
Interest		103,005	—	103,005
Dividends		75	—	75
Less investment expense, other than from securities lending		(3,280)	—	(3,280)
Net income from investing, other than from securities lending		224,707	—	224,707
Securities lending income		399	—	399
Less securities lending expenses		(101)	—	(101)
Net income from securities lending		298	—	298
Net investment income		225,005	—	225,005
Other income		30,748	—	30,748
Total additions		1,329,428	102,085	1,431,513
Deductions:				
Benefits paid to participants:				
Annuities		1,389,103	—	1,389,103
Special benefits		134,882	102,085	236,967
Death benefits		24,438	—	24,438
Refunds of contributions		166,335	—	166,335
Interest on bonds payable		192,947	—	192,947
General and administrative		29,530	—	29,530
Other expenses		26,584	—	26,584
Total deductions		1,963,819	102,085	2,065,904
Net decrease in net position		(634,391)	—	(634,391)
Net position restricted for pensions:				
Beginning of year, as previously reported		731,342	—	731,342
Adjustment of beginning of year net position (note 16)		(16,285)	—	(16,285)
End of year	$	80,666	—	80,666

See accompanying notes to basic financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2014

(1) Organization

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the "System") is a trust created by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) pursuant to Act No. 447 on May 15, 1951 (Act No. 447), as amended, to provide pension and other benefits to retired employees of the Commonwealth, its public corporations and municipalities of Puerto Rico. The System administers a cost-sharing, multi-employer, pension plan (the pension plan). The System also administers post-employment healthcare benefits provided by the Commonwealth to retired plan members (the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities Medical Insurance Plan Contribution – ERS MIPC), an unfunded, cost-sharing, multi-employer defined benefit other postemployment benefit.

The System is considered an integral part of the financial reporting and is included in the Commonwealth's basic financial statements as a pension trust fund. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Income earned by the System is not subject to Federal and Puerto Rico taxes.

The System's governance is vested in a Board of Trustees (the Board), which sets policy and oversees the operations consistent with applicable laws. There are eleven members of the Board, as follows: the Puerto Rico Secretary of the Treasury (or her appointee), the President of the Government Development Bank for Puerto Rico (or his appointee), the Commissioner of Municipal Affairs (or his appointee) and the Director of the Office of Human Resources of the Commonwealth (or his appointee), as ex officio members; three members appointed to three-year terms by the Governor of the Commonwealth (the Governor), two of whom must be members of the System and one member of the Retirement System for the Judiciary of the Commonwealth of Puerto Rico, with at least ten years of credited service; and two members who are a pensioners of each system. The other two members are the President of the Federation of Mayors and the President of the Association of Mayors. The Board is also responsible for appointing the Administrator of the System.

The System and the Retirement System for the Judiciary of the Commonwealth of Puerto Rico (JRS), also a component unit of the Commonwealth, are both administered by Puerto Rico Government Employees and Judiciary Retirement Systems Administration (the Administration). The Administration allocated 98.43% of its general and administrative expenses to the System during the year ended June 30, 2014. The methodology used to determine the allocation is based on total employer and participating employees' contributions to the System, divided by the aggregate total of employers' and participating employees' contributions to the System and JRS, combined.

(2) Summary of Significant Accounting Policies

The following are the significant accounting policies followed by the System in the preparation of its financial statements:

(a) Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP) as applicable to governmental organizations. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has legal requirement to provide the contributions. Benefits and refunds are recognized when legally due and payable.

(b) Use of Estimates

The preparation of the basic financial statements requires management to make significant estimates and assumptions relating to the reporting of assets and liabilities and in the disclosures of contingencies to prepare these financial statements in conformity with GAAP. The System's most significant estimates relate to the total pension liability, and the valuation of certain investments. Due to the inherent nature of these estimates, actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash equivalents include all highly liquid debt instruments with original maturities of three months or less from the date of acquisition. Cash and cash equivalents consist of money market funds, U.S. Treasury bill, and certificates of deposit in Government Development Bank for Puerto Rico (GDB) (a component unit of the Commonwealth) and in commercial banks. Restricted cash deposited with GDB consists of payments received from mortgage loan holders in the servicing of loans (escrow accounts), expired checks not claimed by the plan members, restricted for repayments, and temporary amounts to be transferred to the Bank of New York Mellon (trustee) restricted for bond debt service requirements. Restricted money market funds consist of funds held by the trustee to maintain the debt service funds and the sinking funds for the repayment of the System's bonds payable.

(d) Investments

Investments are reported at fair value. The fair value of investments is based on quoted prices, if available. The System has investments in limited partnerships and nonexchange commingled trust funds valued at approximately $54 million and $750 million, respectively, as of June 30, 2014. Fair values of investments in limited partnerships have been estimated in the absence of readily determinable fair values, based on information provided by the underlying fund managers. Nonexchange commingled trust funds are reported at their net asset value (NAV). The NAV includes the market value of the securities in the fund plus any receivables, payables, and accrued fund expenses.

Securities purchases and sales are recorded on a trade-date basis. Realized gains and losses from the sale of securities and unrealized changes in the fair value of outstanding securities are included in net

appreciation (depreciation) in fair value of investments. Realized gains and losses are computed as the difference between the proceeds of the sale and the cost of the investment sold, determined by the average cost method. Interest income is recorded as earned on an accrual basis. Dividend income is recorded on the ex-dividend date.

(e) Member Loans

Mortgage, personal, and cultural trip loans to plan members are stated at their outstanding principal balance less an allowance for uncollectible amounts. The maximum amount that may be loaned to plan members for mortgage loans is $100,000, and $5,000 for personal, and cultural trip loans.

The System services mortgage loans with aggregate principal balances of approximately $3.2 million at June 30, 2014, related to certain mortgage loans sold to the Federal National Mortgage Association for a fee of 0.25%. The sale contract stipulates that the System must repurchase any loans with payments in arrears over 90 days.

(f) Guarantee Insurance Reserve for Member Loans

Premiums collected and benefits claimed are recorded as additions and deductions, respectively. The guarantee insurance reserve for life insurance on loans to plan members is revised each year and adjusted accordingly based on the annual higher claim amount of a five-year period increased by a management determined percentage.

(g) Capital Assets

Capital assets include building, building improvements, and furniture and equipment. The System defines capital assets as assets with an initial individual cost of $500 or more at the date of acquisition and a useful life equal to or in excess of four years. Capital assets are recorded at historical cost, or their estimated historical cost, if actual historical costs are not available. Donated capital assets are recorded at their estimated fair value at time of donation.

Capital assets are depreciated on the straight-line method over the assets estimated useful life. There is no depreciation recorded for construction in progress. The estimated useful lives of capital assets are as follows:

	Years
Building	50
Buildings improvements	10
Equipment, furniture, fixtures, and vehicles	5–10

(h) Termination Benefits

The System accounts for termination benefits in accordance with GASB Statement No. 47, *Accounting for Termination Benefits*. Pursuant to the provisions of GASB Statement No. 47, the System, as an employer, should recognize a liability and expense for voluntary termination benefits (for example,

early retirement incentives) when the offer is accepted and the amount can be estimated. A liability and expense for involuntary termination benefits (for example, severance benefits) should be recognized when a plan of termination has been approved by those with the authority to commit the government to the plan, the plan has been communicated to the employees, and the amount can be estimated.

(i) ***Adoption of Accounting Pronouncements***

The following new accounting pronouncements were adopted by the System effective July 1, 2013:

a. Effective July 1, 2013, the System adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. GASB Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. GASB Statement No. 65 also requires that debt issuance costs be recognized as a deduction in the period incurred in the statement of changes in fiduciary net position. The impact of adopting GASB Statement No. 65 was to decrease the fiduciary net position as of July 1, 2013 by approximately $29,981,000 reflecting the cumulative retrospective effect of derecognizing the debt issuance costs which had previously been deferred in the statement of fiduciary net position.

b. Effective July 1, 2013, the System adopted GASB Statement No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25*. GASB Statement No. 67 establishes standards of financial reporting for separately issued financial reports and specifies the required approach to measuring the net pension liability of employers for benefits provided through the pension plan, about which information is required to be presented. This Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

   GASB Statement No. 67 requires the disclosures of the components of the net pension liability and the assumptions and other methods used to measure the total pension liability. GASB Statement No. 67 also requires certain additional note disclosures for defined benefit pension plans including the annual money-weighted rate of return on plan investments. GASB Statement No. 67 revised the reporting requirements for required supplementary information to include schedules that provide trend information related to 1) changes in the net pension liability and related ratios, 2) the actuarially and contractually determined contributions of employer contributing entities, and 3) the annual money-weighted rate of return on plan investments.

   Adoption of GASB Statement No. 67 did not impact the fiduciary net position of the System; however certain changes to note disclosures and required supplementary information have been incorporated to comply with the new standard.

(j) Recently Issued Accounting Pronouncements

GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements. The new requirements improve the comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB Statement No. 72 provides fair value application guidance and requires a government to make disclosures about its fair value measurements, the level of fair value hierarchy, and valuation techniques. Additional disclosures are required for certain entities that calculate the net asset value per share (or its equivalent). This Statement is effective for fiscal years beginning after June 15, 2015. Earlier application is encouraged. No impact is expected on the reported amount of investments.

(3) Liquidity Risk and Uncertainties

The System is a mature retirement system with a significant retiree population. Based on the statutory funding requirements, the annual benefit payments and administrative expenses paid by the System were significantly larger than the member and employers' contributions to the System. Thus investment income had to be used to cover negative cash flow. If the increasing and additional contributions stipulated by law are not paid in full on an annual basis, the System will continue being rapidly defunded and gross assets will be exhausted. If measures are not taken to significantly increase the contributions, the System will become insolvent in fiscal year 2018. In addition, annual cash flow estimates for the foreseeable future are presently estimated to be insufficient to cover the System's obligations unless other measures are taken.

If the System's assets are exhausted, it would be operating solely on a "pay-as-you-go" basis, which means that it would be unable to pay benefits that exceed the actual employer and employee contributions received (net of administrative and other expenses), unless the Commonwealth provides the funding required to meet the pay-as-you-go retirement benefits. Additionally, as described in note 10, future employers' contributions have been pledged for the payment of debt service, further depletion of the System's assets could result in the inability to repay its bond obligations. Consequently, the System's funding requirements, together with the funding requirements of JRS and the Puerto Rico System of Annuities and Pensions for Teachers, could have a direct negative effect on the Commonwealth's General Fund, since the Commonwealth is the primary sponsor and is obligated to make contributions to fund each of the systems.

The Commonwealth and the other participating employers have been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. The widening of credit spreads for the Commonwealth's public sector debt, the continued downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to noninvestment grade categories, and the lowered-than-projected revenues have put further strain on the Commonwealth's liquidity and have affected its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

If the Commonwealth's financial condition does not improve as a result of fiscal and budgetary measures it is taking, its ability to repay its obligations, including its regular employer contributions to the System and its additional contribution as provided by Act No. 32 of June 25, 2013 (Act No. 32), for the upcoming years, may continue to be adversely affected, and could also affect the payment of benefits and the repayment of the System's bond payable.

To improve the liquidity and solvency of the System, the Commonwealth enacted Act No. 32, as amended by Act No. 244 of 2014, which provides for incremental annual contributions (additional uniform contribution) from the Commonwealth's General Fund, public corporations and municipalities beginning in fiscal year 2014 and up to the fiscal year 2033. The additional annual contribution determined for fiscal 2014 was defined as $120 million and subsequent annual amounts will be determined annually based on actuarial studies to be performed by the System's actuaries as necessary for the System's gross assets to remain above $1 billion. An appropriation for such additional uniform contribution of approximately $98 million was included in the Commonwealth's budget for the fiscal year 2014. However, as a result of the Commonwealth's General Fund revenue shortfall, compared to budget, the Commonwealth made certain adjustments to the fiscal year 2014 budgetary appropriations following the "priority norms" for the disbursement of public funds that apply during any fiscal year in which the resources available to the Commonwealth are insufficient to cover the appropriations approved for such year. These adjustments included the reduction in full of the portion of the Act No. 32 additional uniform contribution by executive Order 29-2014.

For fiscal year 2015 and 2016, the certification of the additional uniform contribution was not available at least 120 days before the commencement of the applicable fiscal year. Act No. 32, as amended, provides that, in this situation, the additional uniform contribution for the fiscal year will be the additional uniform applicable for the preceding year. Thus, the additional uniform contribution determined for fiscal years 2015 and 2016 was $120 million.

Timely payment of the additional uniform contribution is a critical component of the reform in order for the System to be able to make payments as they come due without depleting all of its assets first. However, as a result of continued budget deficits in fiscal years 2014 and 2015, the Commonwealth and other participating employers have been unable to make the additional uniform contribution required in full for these fiscal years (other than $35.4 million paid by municipalities and public corporations for fiscal year 2014 and $22.7 million paid by the Commonwealth and $37.1 million paid by public corporations and municipalities for fiscal year 2015). In February 2016, the System's actuaries recalculated the additional uniform contribution for fiscal year 2017 and subsequent years. Based on certain assumptions (which do not account for any fiscal adjustment that the Commonwealth may undertake to address its fiscal challenges), the projected additional uniform contribution for fiscal year 2017 and subsequent years was approximately $596 million (of which approximately $370 million corresponds to the Commonwealth, to be funded from its General Fund, and the remaining portion corresponds to the participating public corporations and municipalities).

Remediation Plan

To improve the liquidity and solvency of the System, on July 6, 2011, the Commonwealth enacted Act No. 116 increasing the employers' contribution rate from 9.275% to 10.275% of employee compensation for the 2011-2012 fiscal year, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020.

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447, Act No. 1 of February 16, 1990 (Act No. 1), and Act No. 305 of September 24, 1999 (Act No. 305 or System 2000). Act No. 3 of 2013 (Act No. 3) reformed the System by, among other measures, reducing benefits, increasing employee contributions, and, in the case of active employees who were entitled to the defined benefits program, replacing most of the defined benefit elements with a defined contribution structure. The reform intended to address the Commonwealth's future cash flow needs and "pay-as-you-go" requirements, while recognizing that the System would become insolvent. As such, the reform was intended to provide enough cash for the System to be able to pay benefits (as amended through the reform) and debt service on the pension obligation bonds, while maintaining projected System gross assets at no less than $1 billion at all times.

In order to achieve this goal, the reform contemplated that the Commonwealth and other participating employers would have to provide additional annual funding above the statutorily prescribed contributions as required by Act No. 32. As a long-term plan, it was recognized that constant monitoring would be required to ensure that the System remained on track to meet the reform's goals. The receipt of the additional uniform contribution of Act No. 32 is critical to the System's ability to make payments as they become due.

Act No. 3 established a contributory hybrid program (the Contributory Hybrid Program) similar to the System 2000 program that will eventually result in all active and retired members participating in a member-funded hybrid program. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under Act No. 447 and Act No. 1 (defined benefit program), and thereafter, all future benefits will accrue under the defined contribution formula used for the System 2000 program participants. Ceasing future defined benefit accruals under Act 447 and Act 1 and converting to a member-funded hybrid plan will result in lower benefit payments as these tiers wind down, and will make all future employer contributions available to pay benefits and bonds payable debt service.

Participants in the defined benefit program who as of June 30, 2013 were entitled to retire and receive a pension, may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program. Participants who as of June 30, 2013 were not entitled to retire can retire depending on the new age limits defined by the Contributory Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program.

Participants in the System 2000 program who as of June 30, 2013 had reached the age of 60 may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program. Participants in the System 2000 program who as of June 30, 2013 had not reached the age of 60 can retire depending on the new age limits defined by the Contributory Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program.

In addition, Act No. 3 amended the provisions of the different benefit structures under the System including, but not limited to, the following:

- Retirement age – The retirement age for the frozen accrued benefits of Act No. 447 is gradually increased from age 58 to age 61, and from age 60 to age 65 for System 2000 program members, which results in a delay in cash outflow and thus lower cumulative future benefit payments to these members. Reduced early retirement was eliminated for Act No. 1, which also results in a delay in cash outflow. The retirement age for new employees was increased to age 67.
- Member contributions – The prior member contribution rate of 8.275% (varying for some members) is increased to 10% of pay. While this will result in higher hybrid program benefits in the future, it will provide more assets in the near term that can support current benefit payments and bonds payable debt service.
- Mandated annuitization – System 2000 program notional accounts were available as lump sum payments at termination/retirement. With a full cohort of active System 2000 program members completing careers at roughly the same time that bonds payable principal payments begin, lump sum payments would have had a deleterious effect on the System's assets. Act No. 3 hybrid accounts, which include the System 2000 program accounts, are subject to mandatory annuitization, which will benefit the System on a cash flow basis by stretching out payments over time, thus providing the System "catch-up" time. The System has the authority for determining the annuitization factors and for updating the factors in future years.
- Survivor benefits – Act No. 447 and Act No. 1 offered survivor benefits at no cost to the retiree. For future retirees, the defined benefit portion of the Act No. 447 or Act No. 1 frozen annuity and the hybrid program Act No. 3 annuity will be subject to an actuarially determined reduction if the member elects an annuity with a survivor benefit, resulting in lower future cash outflow.
- The occupational death benefit and the one year of salary death benefit were eliminated for Act No. 447 and Act No. 1 members, resulting in lower future cash outflow.
- Disability benefits, other than those provided under Law No. 127, were eliminated, resulting in lower future cash outflow. (A member who becomes disabled may receive their hybrid account balance and their accrued benefit if applicable under Act No. 447 or Act No. 1).
- Special law benefits are reduced for current retirees and eliminated for future retirees. The Christmas bonus payable to current retirees was reduced from $600 to $200. The summer bonus was eliminated. The employers will continue making contributions to the System as if all special law benefits were still in place for current and future Act No. 447 and Act No. 1 retirees, which will result in additional cash that can be used for benefit payments and bonds payable debt service.
- Minimum benefits – The minimum pension payable was increased from $400 to $500 per month for current retirees only.
- Merit Annuity – The "Merit Annuity" available to participants who joined the System prior to April 1, 1990 was eliminated.

Other measures taken to improve the liquidity of the System include, among others, 1) revision of the personal loan policy by limiting personal and cultural loan amounts to $5,000 each, from $15,000 and $10,000, respectively; and 2) the receipt of a special contribution from the Commonwealth that was invested in junior subordinated capital appreciation bonds issued by the Puerto Rico Sales Tax Financing Corporation (the COFINA Bonds) (see note 12).

The successful implementation of these measures cannot be assured, as it is dependent upon future events and circumstances whose outcome cannot be anticipated.

(4) Plan Description

Pension Benefits

The System administers different benefit structures pursuant to Act No. 447, as amended, including a cost-sharing, multi-employer, defined benefit program, a defined contribution program (System 2000 program) and a contributory hybrid program. Benefit provisions vary depending on member's date of hire. Substantially all full-time employees of the Commonwealth and its instrumentalities (73 Commonwealth agencies, 78 municipalities, and 55 public corporations, including the System) are covered by the System. Membership is mandatory for all regular, appointed, and temporary employees of the Commonwealth at the date of employment. Membership is optional for the Governor of the Commonwealth, Commonwealth secretaries, head of public agencies and instrumentalities, among others.

At July 1, 2013, membership of the System consisted of the following:

Retirees and beneficiaries currently receiving benefits	107,848
Current participating employees - defined benefit	62,163
Current participating employees – System 2000	63,508
Disabled members, receiving benefits	16,649
Total membership	250,168

The benefits provided to members of the System are established by Commonwealth law and may be amended only by the Legislature with the Governor's approval. Act No. 3, in conjunction with other recent funding and design changes, provided for a comprehensive reform of the System. This summary details the provisions under Act No. 3.

Certain provisions are different for the three groups of members who entered the System prior to July 1, 2013 as described below:

- Members of Act No. 447 are generally those members hired before April 1, 1990.
- Members of Act No. 1 are generally those members hired on or after April 1, 1990 and on or before December 31, 1999.
- Members of Act No. 305 (or System 2000) are generally those members hired on or after January 1, 2000 and on or before June 30, 2013.

All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit program and the System 2000 program, and were rehired on or after July 1, 2013, become members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous programs became part of the Contributory Hybrid Program on July 1, 2013.

Each member has a non-forfeitable right to the value of his/her account. Members have three options to invest their contributions. Investment income is credited to the member's account semiannually. The Commonwealth does not guarantee benefits at retirement age.

The assets of the defined benefit program, the defined contribution program and the Contributory Hybrid Program are pooled and invested by the System. Future benefit payments will be paid from the same pool of assets.

This summary of plan provisions is intended to describe the essential features of the plan. All eligibility requirements and benefit amounts shall be determined in strict accordance with the plan document itself.

(a) ***Service Retirements***

(1) ***Eligibility for Act No. 447 Members*** – Act No. 447 members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 447 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 58 with 10 years of credited service, (3) any age with 30 years of credited service, (4) for Public Officers in High Risk Positions (the Commonwealth Police and Firefighter Corps, the Municipal Police and Firefighter Corps and the Custody Office Corps), attainment of age 50 with 25 years of credited service, and (5), for Mayors of municipalities, attainment of age 50 with 8 years of credited service as a Mayor. In addition, Act No. 447 members who attained 30 years of credited service by December 31, 2013 are eligible to retire at any time.

Act No. 447 members who were not eligible to retire as of June 30, 2013 and did not attain 30 years of credited service by December 31, 2013 are eligible to retire upon attainment of the retirement eligibility age shown in the table below with 10 years of credited service.

Date of birth	Attained age as of June 30, 2013	Retirement eligibility age
July 1, 1957 or later	55 or less	61
July 1, 1956 to June 30, 1957	56	60
Before July 1, 1956	57 and up	59

In addition to the requirements in the table above, Act No. 447 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013 and did not attain 30 years of credited service by December 31, 2013 are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

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(2) ***Eligibility for Act No. 1 Members*** – Act No. 1 members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 1 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 65 with 10 years of credited service, (3) for Public Officers in High Risk Positions, any age with 30 years of credited service, and (4) for Mayors, attainment of age 50 with 8 years of credited service as a Mayor.

Act No. 1 members who were not eligible to retire as of June 30, 2013 are eligible to retire upon attainment of age 65 with 10 years of credited service. In addition, Act No. 1 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013 are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

(3) ***Eligibility for System 2000 Members*** – System 2000 members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, System 2000 members could retire upon attainment of age 55 for Public Officers in High Risk Positions and attainment of age 60 otherwise.

System 2000 members who were not eligible to retire as of June 30, 2013 are eligible to retire upon attainment of age 55 for Public Officers in High Risk Positions and upon attainment of the retirement eligibility age shown in the table below otherwise.

Date of birth	Attained age as of June 30, 2013	Retirement eligibility age
July 1, 1957 or later	55 or less	65
July 1, 1956 to June 30, 1957	56	64
July 1, 1955 to June 30, 1956	57	63
July 1, 1954 to June 30, 1955	58	62
Before July 1, 1954	59 and up	61

(4) ***Eligibility for Members Hired after June 30, 2013*** – Attainment of age 58 if a Public Officer in a High Risk Position and attainment of age 67 otherwise.

(b) *Service Retirement Annuity Benefits*

An annuity payable for the lifetime of the member equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447 and Act No. 1 members, the accrued benefit determined as of June 30, 2013. If the balance in the hybrid contribution account is $10,000 or less, it shall be paid as a lump sum instead of as an annuity.

(1) ***Accrued Benefit as of June 30, 2013 for Act No. 447 Members*** – The accrued benefit as of June 30, 2013 shall be determined based on the average compensation, as defined, for Act No. 447 members, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 447 Mayors, the highest compensation, as defined, as a Mayor is determined as of June 30, 2013.

If the Act No. 447 member had at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting to coordinate with social security (the Coordination Plan), the benefit is re-calculated at the Social Security Retirement Age (SSRA), as defined, as 1.5% of average compensation up to $6,600 multiplied by years of credited service, up to 30 years, plus 65% (75% if member was at least age 55 as of June 30, 2013) of average compensation in excess of $6,600.

If the Act No. 447 member had less than 30 years of credited service as of June 30, 2013, and attains 30 years of credited service by December 31, 2013, the accrued benefit equals 55% of average compensation if the member was under age 55 as of June 30, 2013 or 60% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting the Coordination Plan, the benefit is re-calculated at SSRA as 1.5% of average compensation up to $6,600 multiplied by years of credited service, up to 30 years, plus 55% (60% if member was at least age 55 as of June 30, 2013) of average compensation in excess of $6,600. Member contributions received from Act No. 447 members eligible for this transitory benefit during the period beginning July 1, 2013 and ending upon the attainment of 30 years of credited service are considered pre-July 1, 2013 contributions; the contributions to the hybrid contribution account begin after the member attains 30 years of credited service.

If the Act No. 447 member had less than 30 years of credited service as of December 31, 2013, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service up to 20 years, plus 2% of average compensation multiplied by years of credited service in excess of 20 years. Maximum benefit is 75% of average compensation. Except for Commonwealth Police and Commonwealth Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58. For participants selecting the Coordination Plan, the basic benefit is re-calculated at SSRA as 1% of average compensation up to $6,600 multiplied by years of credited service up to 20 years, plus 1.5% of average compensation up to $6,600 multiplied by years of credited service in excess of 20 years, plus 1.5% of average compensation in excess of $6,600 multiplied by years of credited service up to 20 years, plus 2.0% of average compensation in excess of $6,600 multiplied by years of credited service in excess of 20 years. Except for Police and Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58.

For Act No. 447 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation, as defined, as a Mayor for each year of credited service as a Mayor up to 10 years, plus 1.5% of highest compensation as Mayor for each year of non-Mayoral credited service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayoral credited service in excess of 20 years. Non-Mayoral credited service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

(2) Accrued Benefit as of June 30, 2013 for Act No. 1 Members – The accrued benefit as of June 30, 2013 shall be determined based on the average compensation for Act No. 1 members, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 1 Mayors, the highest compensation as a Mayor is determined as of June 30, 2013.

If the Act No. 1 member is a police officer or firefighter with at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013.

For all other Act No. 1 members, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service. The benefit is actuarially reduced for each year payment commences prior to age 65.

For Act No. 1 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation as a Mayor for each year of credited service as a Mayor up to 10 years, plus 1.5% of highest compensation as Mayor for each year of non-Mayoral credited service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayoral credited service in excess of 20 years. Non-Mayoral credited service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

(c) Compulsory Retirement

All Act No. 447 and Act No. 1 Public Officers in High Risk Positions must retire upon attainment of age 58 and 30 years of credited service. A two year extension may be requested by the member from the Superintendent of the Puerto Rico Police, the Chief of the Firefighter Corps, or supervising authority as applicable.

(d) Termination Benefits

(1) Lump Sum Withdrawal

Eligibility: A Member is eligible upon termination of service prior to 5 years of service or if the balance in the hybrid contribution account is $10,000 or less.

Benefit: The benefit equals a lump sum payment of the balance in the hybrid contribution account as of the date of the permanent separation of service.

(2) Deferred Retirement

Eligibility: A Member is eligible upon termination of service with 5 or more years of service (10 years of credited service for Act No. 447 and Act No. 1 members) prior to the applicable retirement eligibility, provided the member has not taken a lump sum withdrawal of the accumulated contributions and the hybrid contribution account.

Benefit: An annuity payable for the lifetime of the member commencing at the applicable retirement eligibility age equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447 and Act No. 1 members, the accrued benefit determined as of June 30, 2013.

(e) *Death Benefits*

(1) Pre-Retirement Death Benefit

Eligibility: Any current nonretired member is eligible.

Benefit: A refund of the hybrid contribution account, plus the accumulated contributions for Act No. 447 and Act No. 1 members.

(2) High-Risk Death Benefit under Act No. 127

Eligibility: Police, firefighters, and other employees in specified high-risk positions who die in the line of work due to reasons specified in Act No. 127 of 1958, as amended.

Spouse's Benefit: 50% of the participant's compensation at date of death, payable as an annuity until death or remarriage.

Children's Benefit: 50% of the participant's compensation at date of death, payable as an annuity, and allocated pro-rata among eligible children. The annuity is payable for life for a disabled child, until age 18 for a nondisabled child not pursuing studies, and until age 25 for a nondisabled child who is pursuing studies.

Benefit if No Spouse or Children: The parents of the member shall each receive 50% of the participant's compensation at date of death, payable as an annuity for life.

Post-death Increases: Effective July 1, 1996 and subsequently every three years, the above death benefits are increased by 3% provided that the beneficiary(ies) had been receiving payments for at least three years.

The cost of these benefits is paid by the Commonwealth's General Fund.

(3) Post-Retirement Death Benefit for Members who Retired prior to July 1, 2013

Eligibility: Any retiree or disabled member receiving a monthly benefit who has not elected a reversionary annuity and whose benefits commenced prior to July 1, 2013.

Benefit: The benefit is as follows (Law No. 105, as amended by Law No. 4):

(i) For those married or with dependent children at the time of death, the annual income to a widow, or widower or dependent children is equal to 60% (50% if in the Coordination Plan – 30% prior to January 1, 2004) of the retirement benefit payable for life for a surviving spouse and/or disabled children and payable until age 18 (age 25 if pursuing

studies) for nondisabled children. If in the Coordination Plan, the benefit to the surviving spouse does not begin until the spouse's attainment of age 60 and the surviving spouse must have been married to the member for at least 10 years to be eligible for this benefit. The increase in the percentage from 30% to 50% if in the Coordination Plan is paid by the General Fund for former government employees or by the public enterprise or municipality for their former employees.

(ii) The benefit, when there is no relation as stated above, is equal to the remaining balance of accumulated contributions at the time of retirement after the deduction of lifetime annual income paid and is payable to a beneficiary or to the member's estate. In no case shall the benefit be less than $1,000. Either the Commonwealth's General Fund for former government employees or the public enterprise or municipality for their former employees pays the difference, up to $250, between (1) the accumulated contributions less the lifetime annual income paid and (2) $1,000. The System pays for the rest.

(4) Post-Retirement Death Benefit for Members who Retired after June 30, 2013

Eligibility: Any retiree or disabled member who began receiving a monthly benefit after June 30, 2013.

Benefit: If the member elected at the time of retirement to transfer a portion of the annuity to a beneficiary by selecting an actuarially equivalent optional form of payment, the applicable survivor benefit.

For all members, the excess, if any, of the hybrid contribution account, plus the accumulated contributions for Act No. 447 and Act No. 1 members, at the time of retirement over the total annuity payments paid to the member and any beneficiary per the terms of the optional form of payment shall be payable to a beneficiary or the member's estate.

(5) Beneficiaries receiving occupational death benefits as of June 30, 2013 continue to be eligible to receive such benefits.

(f) Disability Benefits

(1) Disability

Eligibility: All members are eligible upon the occurrence of disability.

Benefit: The balance of the hybrid contribution account payable as lump sum distribution, an immediate annuity or a deferred annuity at the election of the participant. Act No. 447 and Act No. 1 members remain eligible to receive the accrued benefit as of June 30, 2013 commencing at the applicable retirement eligibility age.

(2) High Risk Disability under Act No. 127

Eligibility: Police, firefighters, and other employees in specified high-risk positions who are disabled in the line of work due to reasons specified in Act No. 127 of 1958 (as amended).

Benefit: 80% (100% for Act No. 447 members) of compensation as of date of disability, payable as an annuity. If the member dies while still disabled, this annuity benefit continues to his beneficiaries. Beneficiaries include the surviving spouse and/or disabled children (for life), nondisabled children until age 18 (age 25 if pursuing studies), and the parents if no other beneficiaries. Effective July 1, 1996 and subsequently every three years, the disability benefit is increased by 3% provided that the member (or beneficiary) had been receiving payments for at least three years (Act No. 127 of 1958, as amended). The cost of these benefits is paid by the Commonwealth's General Fund.

(3) Members who qualified for occupational or nonoccupational disability benefits as of June 30, 2013 continue to be eligible to receive such benefits.

(g) Special Benefits

(1) Minimum Benefits

(i) Past Ad hoc Increases

The Legislature, from time to time, increases pensions for certain retirees as described in Act No. 124 approved on June 8, 1973 and Act No. 23 approved on September 23, 1983. The benefits are paid 50% by the Commonwealth's General Fund and 50% by the System.

(ii) Minimum Benefit for Members who Retired before July 1, 2013 (Act No. 156 of 2003, Act No. 35 of 2007, and Act No. 3)

The minimum monthly lifetime income for members who retired or become disabled before July 1, 2013 is $500 per month effective July 1, 2013 ($400 per month effective July 1, 2007 and $300 per month up to June 30, 2007). The increase in the minimum monthly benefit from $200 per month to $300 per month is paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees. The increase in the minimum monthly benefit from $300 per month to $400 per month is to be paid by the System for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

(iii) Coordination Plan Minimum Benefit

A minimum monthly benefit is payable upon attainment of SSRA such that the benefit, when added to the Social Security Benefit, is not less than the benefit payable prior to SSRA.

(2) Cost-of-Living Adjustments (COLA) to Pension Benefits

The Legislature, from time to time, increases pensions by 3% for retired and disabled members. Beneficiaries are not entitled to COLAs granted after the retiree's death. The first increase was

granted by Act No. 10 of 1992. Subsequent 3% increases have been granted every third year since 1992, with the latest 3% increase established on April 24, 2007 and effective July 1, 2007 (retroactive to January 1, 2007) for retired and disabled members that were receiving a monthly benefit on or before January 1, 2004. In addition, effective July 1, 2008, any retired or disabled member that was receiving a monthly annuity on or before January 1, 2004 less than $1,250 per month received an increase of up to 3% without exceeding the limit of $1,250 per month. The COLAs granted in 1992 to all retirees and in 1998 to retirees who are former government or municipal employees shall be paid by the System. All other COLAs granted in 1995 and later shall be paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

(3) Special "Bonus" Benefits

(i) Christmas Bonus (Act No. 144, as Amended by Act No. 3)

An annual bonus of $200 for each retiree, beneficiary, and disabled member paid in December provided the member retired prior to July 1, 2013. This benefit is paid from the supplemental contributions received from the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

(ii) Medication Bonus (Act No. 155, as Amended by Act No. 3)

An annual bonus of $100 for each retiree, beneficiary, and disabled member to cover health costs paid in July provided the member retired prior to July 1, 2013. Evidence of coverage is not required. The amount is prorated if there are multiple beneficiaries. This benefit is paid from the supplemental contributions received from the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

(h) Contributions

(1) Member Contributions

Effective July 1, 2013, contributions by members are 10% of compensation. However, for Act No. 447 members who selected the Coordination Plan, the member contributions are 7% of compensation up to $6,600 plus 10% of compensation in excess of $6,600 during the 2013-2014 fiscal year and 8.5% of compensation up to $6,600 plus 10% of compensation in excess of $6,600 during the 2014-2015 fiscal year. Members may voluntarily make additional contributions to their hybrid contribution account.

Prior to July 1, 2013, contributions by Act No. 447 members selecting the Coordination Plan were 5.775% of compensation up to $6,600 plus 8.275% of compensation in excess of $6,600.

Contributions by all other members were 8.275% of compensation. System 2000 members may also have made voluntary contributions of up to 1.725% of compensation prior to July 1, 2013.

(2) Employer Contributions (Article 2-116, as Amended by Law No. 116 of 2010 and Act No. 3)

Prior to July 1, 2011, employer contributions were 9.275% of compensation. Effective July 1, 2011, employer contributions are 10.275% of compensation. For the next four fiscal years effective July 1, employer contributions will increase annually by 1% of compensation. For the five fiscal years thereafter, employer contributions will increase annually by 1.25% of compensation, reaching an employer contribution rate of 20.525% of compensation effective July 1, 2020.

(3) Supplemental Contributions from the Commonwealth's General Fund, Certain Public Corporations, and Municipalities (Act No. 3)

Effective July 1, 2013, the System will receive a supplemental contribution of $2,000 each fiscal year for each pensioner (including beneficiaries receiving survivor benefits) who was previously benefitting as an Act No. 447 or Act No. 1 member while an active employee. This supplemental contribution will be paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

(4) Additional Uniform Contribution (Act No. 32, as Amended)

The additional uniform contribution will be certified by the external actuary of the System each fiscal year from 2014-2015 through 2032-2033 as necessary to avoid having the projected gross assets of the System, during any subsequent fiscal year, to fall below $1 billion. The additional uniform contribution is to be paid by the Commonwealth's General Fund, public corporations with own treasuries, and municipalities. The additional uniform contribution determined for fiscal years 2014, 2015 and 2016 was $120 million. The additional uniform contribution determined for fiscal year 2016-2017 is $596 million, payable at the end of the fiscal year.

(i) Early Retirement Programs

The Puerto Rico Environmental Quality Board (EQB) implemented an early retirement program for its employees under the Law 224 Act No. 7 dated August 9, 2008. EQB has already made the initial payment and would reimburse the remaining balance on annuities and other benefits paid by the System in four installments on each July 31 starting in 2009 through 2012. The EQB was at default on the retirement plan payment, so they requested a new payment plan. The ERS Board of Trustees approved a Payment Plan for the debt balance due of the Retirement program for 24 months starting in March 2014.

On July 2, 2010, the Commonwealth enacted Act No. 70 establishing a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined. Act No. 70 of 2010 (Act No. 70) also established that early retirement benefits

will be provided to eligible employees that have completed between 15 to 29 years of creditable services and will consist of monthly benefits ranging from 37.5% to 50% of each employees' monthly salary. Benefits under this program will be paid by the General Fund of the Commonwealth (the General Fund) and by the public corporations, covering their respective employees until the plan member reaches the later of age 55 for members under Act No. 447 or age 65 for members under Act No. 1, or the date the plan member would have completed 30 years of service had the member continued employment. In addition, the public corporations will also be required to continue making the required employee and employer contributions to the System. The General Fund will be required to continue making its required employer contributions. The System will be responsible for benefit payments afterwards.

The contribution requirement to the System is established by law and is not actuarially determined. The special benefits contributions of approximately $229 million in 2014 mainly represent contributions from the Commonwealth's General Fund, public corporations and municipalities for the special benefits identified above granted by special laws. The funding of the special benefits is provided to the System through legislative appropriations each July 1 by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees, and by certain public corporations with own treasuries and municipalities for their former employees. The legislative appropriations are considered estimates of the payments to be made by the System for the special benefits. Deficiencies in legislative appropriations are covered by the System's own funds until recovered through future legislative appropriations. Any surplus of legislative appropriations collected over special benefits paid is combined with the assets held in trust for the payment of other pension benefits.

(j) Other Postemployment Benefits (OPEB) – Healthcare Benefits

ERS MIPC is a cost-sharing, multi-employer defined benefit other postemployment benefit plan sponsored by the Commonwealth. ERS MIPC covers a payment of up to $100 per month to the eligible medical insurance plan selected by the member provided the member retired prior to July 1, 2013 (Act No. 483, as amended by Act No. 3). Substantially all fulltime employees of the Commonwealth's primary government, and certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own postemployment benefit plan, were covered by the OPEB.

Commonwealth employees became members upon their date of employment. Plan members were eligible for benefits upon reaching the pension benefits retirement ages.

At July 1, 2013, the membership, as adjusted by changes in participants established by Act No. 3, consisted of the following:

Membership:	
Retired members	94,395
Disabled members	16,649
Total membership	111,044

The contribution requirement of ERS MIPC is established by Act No. 95 approved on June 29, 1963. This OPEB plan is financed by the Commonwealth on a pay-as-you-go basis. There is no contribution requirement from the plan member during active employment. Retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. As a result, these OPEB are 100% unfunded. During the year ended June 30, 2014, OPEB contributions amounted to $102 million.

The funding of the OPEB benefits is provided to the System through legislative appropriations each July 1 by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees, and by certain public corporations with own treasuries and municipalities for their former employees. The legislative appropriations are considered estimates of the payments to be made by the System for the healthcare benefits throughout the year.

(5) Net Pension Liability

The components of the net pension liability as of June 30, 2014 were as follows (dollars in thousands):

Total pension liability	$	30,219,517
Plan's fiduciary net position		80,666
Net pension liability	$	30,138,851
Plan's fiduciary net position as a percentage of the total pension liability		0.27%

(a) Actuarial Methods and Assumptions

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for the current valuation. The liability results as of June 30, 2014 are based on projecting the System obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability gains or losses.

The actuarial valuation used the following actuarial assumptions:

Inflation	2.50%
Municipal bond index	4.29%, as per Bond Buyer General Obligation 20-Bond Municipal Bond Index
Projected salary increases	3.00% per year. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66 and the current general economy.
Mortality	Pre-retirement Mortality: For general employees not covered under Act No. 127, RP-2000 Employee Mortality Rates for males and females projected on a generational basis using Scale AA. For members covered under Act No. 127, RP-2000 Employee Mortality Rates with blue collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational for members covered under Act No. 127.
	Post-retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females. The rates are projected on a generational basis starting in 1994 using Scale AA. As a generational table, it reflects mortality improvements both before and after the measurement date.
	Post-retirement Disabled Mortality: Rates which vary by gender are assumed for disabled retirees based on a study of plan's experience from 2007 to 2012 equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. No provision was made for future mortality improvement for disabled retirees.

Most other demographic assumptions used in the July 1, 2013 valuation were based on the results of an actuarial experience study using data as of June 30, 2003, June 30, 2005 and June 30, 2007.

(b) Long-term Expected Rate of Return

The long-term expected rate of return on pension benefits investments was determined in accordance with the asset allocation of the portfolio that was adopted by the Board during December 2013 and the actuary's capital market assumptions as of June 30, 2014. The long-term expected rate of return on pension benefits investments of 6.75% as of June 30, 2014 was slightly higher than the debt service of the senior pension funding bonds payable which range from 5.85% to 6.55%.

The pension plan's policy in regard to allocation of invested assets is established and may be amended by the Board. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on the System's financial condition for the benefits provided through

the pension programs. The following was the Board's adopted asset allocation policy as of June 30, 2014:

Asset class	**Target allocation**	**Long-term expected rate of return**
Domestic equity	25%	6.8%
International equity	10	7.6
Fixed income	64	3.9
Cash	1	2.9
Total	100%	

The long-term expected rate of return on pension benefits investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

(c) Discount Rate

The asset basis for the date of depletion projection is the System's fiduciary net position (the gross assets plus deferred outflows of resources less the gross liabilities, including the senior pension funding bonds payable, plus deferred inflows of resources). On this basis, the System's fiduciary net position was expected to be exhausted in the fiscal year 2015.

The System's fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the tax free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability. The discount rate was 4.29% as of June 30, 2014.

The date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No. 32 because of actual fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth and the municipalities, and in the event that their financial condition do not improve in the near term.

The June 30, 2014, actuarial valuation reflects an increase of $1,198 million in the total pension liability as a result of the changes in assumptions related to the change in the discount rate as required by GASB Statement No. 67 and an increase of $54 million in the total pension liability as a result differences between expected and actual experience.

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(d) Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability calculated using the discount rate of 4.29%, as well as what it would be if it were calculated using a discount rate of 1 percentage-point lower (3.29%) or 1 percentage-point higher (5.29%) than the current rate (dollars in thousands):

		1% Decrease (3.29%)	Current discount rate (4.29%)	1% Increase (5.29%)
Net pension liability	$	34,191,176	30,138,851	26,783,118

(6) Cash and Cash Equivalents, Investments and Securities Lending Transactions

Cash and Cash Equivalents

Cash and cash equivalents as of June 30, 2014 consisted of the following (in thousands):

		Carrying amount	Depository bank balance	Amount uninsured and uncollateralized
Deposits with GDB	$	71,508	114,657	114,657
Deposits with GDB held by the Puerto Rico Department of Treasury		3,470	72,832	72,832
Deposits with Puerto Rico commercial banks		12,529	12,529	—
Money market funds		177,535	N/A	N/A
U.S. Treasury bill		4,450	N/A	—
Total	$	269,492	200,018	187,489

N/A= Not applicable.

Custodial credit risk for deposits is the risk that, in an event of the failure of a depository financial institution, the System may not be able to recover deposits or collateral securities that are in the possession of an outside party. The Commonwealth requires that public funds deposited in Puerto Rico commercial banks be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. Deposits with GDB and with non Puerto Rico commercial banks and money market funds are uninsured and uncollateralized, as these entities are exempt from compliance with the collateralization requirement

Investments

For the year ended June 30, 2014, the annual money-weighted rate of return on investments, net of investment expenses, was 11.2%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

The System's investments are exposed to custodial credit risk, credit risk, concentration of credit risk, foreign currency risk, and interest rate risk. Following is a description of these risks as of June 30, 2014:

(a) Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2014, securities investments were registered in the name of the System and were held in the possession of the System's custodian banks, except for securities lent. Securities lent are not exposed to custodial credit risk. Cash collateral received from securities lending transactions invested in short-term investments is exposed to custodial credit risk.

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All fixed-income securities at the time of purchase must be of investment grade quality. All issuances shall be rated investment grade by at least two of the nationally recognized rating agencies. The portfolio is expected to maintain a minimum weighted average credit quality of either "A–" or better.

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The credit quality ratings of bonds and notes and nonexchange commingled fixed income trust fund as of June 30, 2014, are as follows (in thousands):

	RATING (1)						
Investment type	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	Not rated	Total
Bonds and notes:							
U.S. government agencies obligations:							
Federal Home Loan Bank (FHLB) $	—	14,943	—	—	—	—	14,943
Federal National Mortgage Association (FNMA)	—	8,319	—	—	—	—	8,319
Federal Home Loan Mortgage Corporation (FHLMC)	—	13,242	—	—	—	—	13,242
Federal Farm Credit Banks (FFCB)	—	5,794	—	—	—	—	5,794
Mortgage and asset-backed securities:							
FNMA	—	4,942	—	—	—	—	4,942
FHLMC	—	2,496	—	—	—	—	2,496
Collateralized mortgage obligations (CMO) – others	—	—	—	—	—	286	286
Commercial mortgages	15,547	—	—	—	—	—	15,547
Asset-backed securities	—	69	—	—	—	—	69
U.S. corporate bonds and notes	12,955	89,411	406,551	308,134	25,969	11,838	854,858
Non U.S. corporate bonds	—	22,607	66,915	61,478	3,641	12,465	167,106
U.S. municipal bonds	2,769	4,132	3,256	—	—	—	10,157
Commonwealth bonds	—	—	—	—	995	—	995
COFINA bonds	—	—	138,123	—	—	—	138,123
Total bonds and notes	31,271	165,955	614,845	369,612	30,605	24,589	1,236,877
Nonexchange commingled fixed income trust fund – SSgA Intermediate fund	8,071	8,893	25,782	26,300	—	—	69,046
Total $	39,342	174,848	640,627	395,912	30,605	24,589	1,305,923

(1) Rating obtained from Standard & Poor's or equivalent rating by Moody's Investor Service or Fitch Ratings.

Approximately $100 million of the total System investments consist of U.S. government and Government National Mortgage Association (GNMA) mortgage-backed securities, which carry no risk, therefore, not included within the above table.

The System invests in a U.S. fixed income fund which consists of shares of the State Street Global Advisor (SSgA) Intermediate U.S. Credit Index Non-Lending Fund (SSgA Intermediate Fund). The investment objective of the SSgA Intermediate Fund is to replicate the Barclays U.S. Intermediate Credit Bond Index by investing exclusively in fixed income securities. Shares of the SSgA Intermediate Fund can be redeemed on a daily basis at NAV and have no redemption restrictions.

(c) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. As of June 30, 2014, there are no investments in any issuer that represent 5% or more of the System's total investments, except for its investment in COFINA Bonds further described in note 12.

(d) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, the System manages its exposure to declines in fair values by structuring the investment portfolio so that securities mature to meet cash requirements for benefit payments, thereby avoiding the need to sell securities on the open market prior to maturity. Investments in equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. The System is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment grade intermediate credit and core fixed-income securities.

The contractual maturity of investments as of June 30, 2014, is summarized below (in thousands). Expected maturities will differ from contractual maturities, because counterparties may have the right to call or prepay obligations with or without call or prepayment penalties.

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Investment type		Maturity (in years) Within one year	After one to five years	After five to ten years	After ten years		Total
Bonds and notes:							
U.S. government securities:							
U.S. Treasury notes	$	—	25,122	24,612	—		49,734
U.S. Treasury note strips		—	—	40,852	—		40,852
U.S. Treasury bonds		—	—	—	417		417
U.S. government sponsored agencies notes:							
FHLB		6,214	2,256	6,473	—		14,943
FNMA		—	4,942	3,377	—		8,319
FHLMC		—	9,756	3,486	—		13,242
FFCB		—	4,153	1,641	—		5,794
Mortgage and asset-backed securities:							
GNMA		—	—	—	9,412		9,412
FNMA		616	—	488	3,838		4,942
FHLMC		—	—	—	2,496		2,496
Collateralized mortgage obligations (CMO) – others		—	—	—	286		286
Commercial mortgages		—	—	—	15,547		15,547
Asset-backed securities		—	69	—	—		69
U.S. corporate bonds and notes		77,228	425,891	322,278	29,461		854,858
Non U.S. corporate bonds		19,411	69,220	76,356	2,119		167,106
U.S. municipal bonds		—	3,403	4,593	2,161		10,157
Commonwealth bonds		995	—	—	—		995
COFINA bonds		—	—	—	138,123		138,123
Total bonds and notes		104,464	544,812	484,156	203,860		1,337,292
Nonexchange commingled fixed income trust fund – SSgA Intermediate Fund (1):							
U.S.		—	45,101	—	—		45,101
Non-U.S.		—	23,945	—	—		23,945
Total bonds and notes and nonexchange commingled fixed income trust fund	$	104,464	613,858	484,156	203,860		1,406,338
Stocks, nonexchange commingled equity trust funds and investments in limited partnerships:							
Non-U.S. corporate stock						$	102
Nonexchange commingled equity trust funds:							
U.S. – SSgA Russell 3000 Fund							513,545
Non-U.S. – SSgA MSCI ACWI Ex USA Fund							167,891
Investments in limited partnerships							54,146
Total stocks, nonexchange commingled equity trust funds and investments in limited partnerships							735,684
Total investments						$	2,142,022

(1) Nonexchange commingled fixed income trust fund was classified based on effective duration.

(Continued)

(e) *Foreign Currency Risk*

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. As of June 30, 2014, the SSgA MSCI ACWI Ex USA Fund is subject to foreign currency risk.

As of June 30, 2014, the composition of the underlying investments in the SSgA MSCI ACWI Ex USA Fund by country was as follows:

Country	SSgA MSCI ACWI EX USA Fund
United Kingdom	15%
Japan	14
Canada	8
France	7
Germany	7
Switzerland	6
Australia	6
China	4
Korea	3
Taiwan	3
Spain	3
Brazil	2
Hong Kong	2
Netherlands	2
South Africa	2
Sweden	2
Italy	2
Denmark	1
India	1
Mexico	1
Russia	1
Singapore	1
Others	7
Total	100%

 (Continued)

Nonexchange Commingled Trust Funds

As of June 30, 2014, the System owned shares in the SSgA Russell 3000 Index Non-Lending Fund (SSgA Russell 3000 Fund), the SSgA MSCI ACWI Ex USA Non-Lending Fund (SSgA MSCI ACWI Ex USA Fund), and the SSgA Intermediate Fund as follows (in thousands):

Fund name	Shares		Value
SSgA Russell 3000 Fund	25,614	$	513,545
SSgA MSCI ACWI Ex USA Fund	8,764		167,891
SSgA Intermediate Fund	2,409		69,046
Total nonexchange commingled trust funds		$	750,482

The investment objective of the Russell 3000 Fund is to approximate as closely as practicable, before expenses, the performance of the Russell 3000 Index over the long term. Shares can be redeemed on a daily basis at NAV and have no redemption restrictions.

The investment objective of the SSgA MSCI ACWI Ex USA Fund is to approximate as closely as practicable, before expenses, the performance of the MSCI ACWI ex USA Index over the long term. Shares can be redeemed semi-monthly at NAV and have no redemption restrictions.

As of June 30, 2014, the investments underlying the SSgA Russell 3000 Fund, SSgA MSCI ACWI Ex USA Fund, and the SSgA Intermediate Fund had the following sector allocations:

Sector	SSgA Russell 3000 Fund	SSgA MSCI ACWI Ex USA Fund
Information technology	18%	7%
Financials	17	26
Healthcare	13	8
Consumer discretionary	13	11
Industrials	12	11
Energy	10	10
Consumer staples	8	10
Materials	4	8
Utilities	3	4
Telecommunication services	2	5
	100%	100%

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	SSgA Intermediate Fund
Corporate – Industrial	45%
Corporate – Finance	30
Non Corporates	21
Corporate – Utility	4
Total	100%

Investments in Limited Partnerships

The fair value of investments in limited partnerships at June 30, 2014, amounted to approximately $54 million and is presented as private equity investments in the basic Statement of Fiduciary Net Position. The allocations of net gains and losses to limited partners are based on certain percentages, as established in the limited partnership agreements. Investments in limited partnerships are not rated by a nationally recognized statistical rating organization.

In accordance with the partnership agreements, the System's investments can only be redeemed upon distribution from funds managers; usually in the form of a sale of its holdings or dividends distributed. As of June 30, 2014, the System does not intend to sell its investments in limited partnerships for an amount different to that presented in the financial statements.

As of June 30, 2014, the date of commitment, total commitment, 2014 contributions, contributions to date at cost, and estimated fair value of investments in limited partnerships are as follows (in thousands):

	Date of commitment	Total commitment	2014 Contributions	Contributions to date at cost	Estimated fair value
Grupo Guayacán, Inc.:					
Guayacán Fund of Funds, LP	September 1996	$ 25,000	—	23,820	52
Guayacán Fund of Funds II, LP	August 1999	25,000	—	23,681	2,907
Advent-Morro Equity Partner, Inc.:					
Guayacán Private Equity Fund, LP	January 1997	5,000	—	4,645	3,516
Guayacán Private Equity Fund II, LP	April 2007	25,000	892	19,922	20,343
Venture Capital Fund, Inc.	November 1995	800	—	800	875
GF Capital Management and Advisors, LLC – GF Capital Private Equity Fund LP	December 2006	25,000	216	25,792	22,830
Chase Capital Partners Private: Equity Fund of Funds Corporate Investors II, LTD	July 2000	20,000	39	18,994	3,623
Martineau Bay Resort, s. en c. (s.e.)	July 1998	1,796	—	1,796	—
Total		$ 127,596	1,147	119,450	54,146

Securities Lending Transactions

The System participates in a securities lending program, whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, government securities, and/or irrevocable bank letters of credit with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily and the agent places a request for additional collateral from brokers, if needed. The custodian bank is the agent for the securities lending program.

At the end of the year, there was no credit risk exposure to borrowers because the amounts the System owes the borrowers (the collateral) exceeded the amounts the borrowers owe the System (the securities lent). At June 30, 2014, the collateral received represented 102% of the fair value of the total securities lent.

The securities on loan for which collateral was received as of June 30, 2014, consisted of the following (in thousands):

Description		Fair value of underlying securities
U.S. government securities:		
U.S. Treasury bill	$	2,000
U.S. Treasury notes		19,921
U.S. Treasury note strips		12,492
U.S. government sponsored agencies notes:		
FNMA		1,474
FHLMC		4,134
U.S. corporate bonds and notes		83,662
Total	$	123,683

The underlying collateral for these securities had a fair value of approximately $126.6 million as of June 30, 2014. The collateral received was invested in a money market fund sponsored by the custodian bank. As of June 30, 2014, the short-term investment fund consisted of securities purchased under agreements to resell.

Under the terms of the securities lending agreement, the System is fully indemnified against failure of the borrowers to return the securities lent (to the extent the collateral is inadequate to replace the securities lent) or failure to pay the System for income distributions by the securities' issuers while the securities are on loan. In addition, the System is indemnified against loss should the lending agent fail to demand adequate and appropriate collateral on a timely basis.

(7) Accounts Receivable from Employers

As of June 30, 2014, accounts receivable from employers consisted of the following (in thousands):

Early retirement programs	$	3,790
Special laws		104,572
Employer and employee contributions		154,295
Interest on late payments		15,994
Total accounts receivable from employers		278,651
Less allowance for adjustments and losses in realization		(82,848)
Total accounts receivable from employers- net	$	195,803

According to Act No. 447, each employer must pay, on a monthly basis, the amounts corresponding to contributions and loan repayments, on or before the fifteenth day of the following month. After that date, interest is charged as established by the System.

As more fully described in note 2, the Commonwealth and many of its instrumentalities, which are the employers as it relates to the System, have been facing significant fiscal and economic challenges. Further, in recent months, the rating downgrade and widening of credit spreads for the Commonwealth's public sector and public corporations' debt has put further strain on liquidity and sources of funding of the employers. Consequently, most of the receivables from employers are delinquent past established payment dates and/or installment plan due dates. In other instances, amounts past due have continued to be renegotiated to later dates.

As of June 30, 2014, the System recorded an allowance of $82.8 million for adjustments and losses in realization of the additional uniform contribution due from the Commonwealth because, as explained in note 2, its collectability is uncertain at this moment.

Although certain measures have been taken to improve the collection of such receivables, the timing of collections from employers affects the liquidity needs of the System. Management is of the opinion that, except for the additional uniform contribution of the Commonwealth of $82.8 million, other amounts due from employers are collectible; however this situation could ultimately affect the payment of benefits to members or repayment of the System's bonds payable, should any such amounts become uncollectible in the future.

(8) Member Loans and Interest Receivable

Loans receivable from plan members are guaranteed by the contributions of plan members and by other sources, including mortgage deeds and any unrestricted amount remaining in the escrow funds. In addition, collections on loans receivable are received through payroll withholdings. For the year ended June 30, 2014 the maximum amount of loans to plan members for mortgage loans was $100,000 and $5,000 for personal and cultural trip loans. During the years ended June 30, 2014 and 2013, personal loans with principal balances amounting to approximately $100 million and $88 million, respectively, were sold to two financial

institutions. As per servicing agreements, the System is in charge of the servicing, administration and collection of the loans and outstanding principal balances at and after closing date for a servicing fee of 2%.

The allowance for adjustments and losses in realization is considered a general allowance for all categories of loans and interest receivable, except mortgage loans, and also a specific allowance for the special collection project loans balances.

As of June 30, 2014, the composition of loans and interest receivable from plan members is summarized as follows (in thousands):

Loans receivable:		
Personal	$	374,505
Mortgage		164,416
Cultural trips		44,792
Total loans to plan members		583,713
Accrued interest receivable		40,036
Less allowance for adjustments and losses in realization		(4,370)
Total loans and interest receivable from plan members – net	$	619,379

(9) Other Assets

As of June 30, 2014, other assets consist of (in thousands):

Executed land	$	4,699
Repossessed and foreclosed properties		996
Total	$	5,695

Repossessed and foreclosed properties consist mainly of properties acquired through foreclosure proceedings related to delinquent mortgage loans. Foreclosed properties are valued at the outstanding principal balance of the related mortgage loan upon foreclosure. These properties will be sold under a bidding process intended to recover the outstanding principal balance of the related mortgage loan. A gain or loss is recognized at the time of sale.

Differences resulting from the recognition of losses at the point of sale rather than upon foreclosure, as required by GAAP in the United States of America, are not material. Management believes that the carrying value of these properties approximates fair value.

(10) Bonds Payable

Senior Pension Funding Bonds – On February 27, 2007, the System's administration and GDB, acting as the System's fiscal agent (the Fiscal Agent), presented to the Board of Trustees, a financial transaction for the issuance of pension funding bonds in order to reduce the System's unfunded actuarial accrued liability. The

Bonds are limited, nonrecourse obligations of the System, payable solely from and secured solely by a pledge of employer contributions made after the date of issuance of the first series of Bonds, and from funds held on deposit with the Bank of New York (the Fiscal Agent). The Bonds are not payable from contributions made to the System by participating employees, or from the assets acquired with the proceeds of the Bonds, or from employer contributions released by the Fiscal Agent to the System after funding of required reserves, or from any other assets of the System. The System invested the proceeds of the Bonds and used these investments and the earnings thereon to provide pension benefits to its beneficiaries.

On January 31, 2008, the System issued the first series of Bonds, which consisted of approximately $1,589 million aggregate principal amount of Senior Pension Funding Bonds, Series A (the Series A Bonds). On June 2, 2008, the System issued the second of such series of Bonds, which consisted of approximately $1,059 million aggregate principal amount of Senior Pension Funding Bonds, Series B (the Series B Bonds). Finally, on June 30, 2008, the System issued the third and final of such series of Bonds, which consisted of approximately $300 million aggregate principal amount of Senior Pension Funding Bonds, Series C (the Series C Bonds).

The following is a summary of changes in the bonds payable principle balance (in thousands):

	Maturity	Balance at June 30, 2013	Accretion	Balance at June 30, 2014
5.85% to 6.45% Term and Capital Appreciation Bonds Series A	2023-2058	$ 1,606,462	3,965	1,610,427
6.25% to 6.55% Term and Capital Appreciation Bonds Series B	2028-2058	1,150,468	22,019	1,172,487
6.15% to 6.50% Term and Capital Appreciation Bonds Series C	2028-2043	301,036	199	301,235
Bond discounts		(6,777)	215	(6,562)
Total		$ 3,051,189	26,398	3,077,587

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2014

As of June 30, 2014, the outstanding principal balance of the Bonds is as follows (in thousands):

Description		
Series A Bonds:		
Capital Appreciation Bonds, maturing in 2028, bearing interest at 6.20%	$	66,657
Term Bonds, maturing in 2023, bearing interest at 5.85%		200,000
Term Bonds, maturing from 2031 through 2038, bearing interest at 6.15%		679,000
Term Bonds, maturing from 2039 through 2042, bearing interest at 6.20%		332,770
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.45%		332,000
Total Series A Bonds outstanding		1,610,427
Series B Bonds:		
Capital Appreciation Bonds, maturing from 2028 through 2030, bearing interest at 6.40%		207,034
Capital Appreciation Bonds, maturing from 2031 through 2034, bearing interest at 6.45%		149,353
Term Bonds, maturing in 2031, bearing interest at 6.25%		117,100
Term Bonds, maturing from 2036 through 2039, bearing interest at 6.30%		270,000
Term Bonds, maturing from 2055 through 2058, bearing interest at 6.55%		429,000
Total Series B Bonds outstanding		1,172,487
Series C Bonds:		
Capital Appreciation Bonds, maturing in 2030, bearing interest at 6.50%		3,235
Term Bonds, maturing in 2028, bearing interest at 6.15%		110,000
Term Bonds, maturing in 2038, bearing interest at 6.25%		45,000
Term Bonds, maturing in 2043, bearing interest at 6.30%		143,000
Total Series C Bonds outstanding		301,235
Total bonds outstanding		3,084,149
Less bonds discount		(6,562)
Bonds payable – net	$	3,077,587

Series A Bonds – The aggregate principal amount of the Series A Bonds issued amounted to approximately \$1,589 million of which \$1,544 million were issued as term bonds (the Series A Term Bonds) and \$45 million were issued as capital appreciation bonds (the Series A Capital Appreciation Bonds). Interest in the Series A Term Bonds are payable monthly on the first day of each month. Interest on the Series A Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Capital Appreciation Bonds on each January 1 and July 1 (Compounding Dates), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360 day year consisting of twelve 30 day months.

The Series A Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of

Series A Capital Appreciation Bonds, the accreted amount) of the Series A Bonds, plus accrued interest to the redemption date, and without premium.

In addition, the following Series A Term Bonds are subject to mandatory redemption in part commencing on July 1, 2021 to the extent of the sinking fund requirement for said bonds set forth below at a redemption price equal to 100% of the principal amount thereof plus accrued interest as follows (in thousands):

Redemption period	Subject bonds		Amount
July 1, 2021	Term bonds (final maturity July 1, 2023)	$	50,000
July 1, 2022	Term bonds (final maturity July 1, 2023)		70,000
July 1, 2023	Term bonds (final maturity July 1, 2023)		80,000
	Subtotal		200,000
July 1, 2034	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2035	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2036	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2037	Term bonds (final maturity July 1, 2038)		133,500
July 1, 2038	Term bonds (final maturity July 1, 2038)		133,500
	Subtotal		667,500
Total		$	867,500

The System complied with the sinking fund requirements at June 30, 2014.

Series B Bonds – The aggregate principal amount of the Series B Bonds amounted to approximately $1,059 million of which $816 million were issued as term bonds (the Series B Term Bonds) and $243 million were issued as capital appreciation bonds (the Series B Capital Appreciation Bonds). Interest in the Series B Term Bonds are payable monthly on the first day of each month. Interest on the Series B Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Series B Capital Appreciation Bonds on each January 1 and July 1 (Compounding Dates), and are treated as if accruing in equal daily amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360 day year consisting of twelve 30 day months.

The Series B Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series B Capital Appreciation Bonds, the accreted amount) of the Series B Bonds, plus accrued interest to the redemption date, and without premium.

Series C Bonds – The aggregate principal amount of the Series C Bonds amounted to approximately $300 million of which $298 million were issued as term bonds (the Series C Term Bonds) and $2 million were issued as capital appreciation bonds (the Series C Capital Appreciation Bonds). Interest in the Series C Term Bonds are payable monthly on the first day of each month. Interest on the Series C Capital Appreciation Bonds are not payable on a current basis, but are added to the principal of the Series C Capital Appreciation Bonds on each January 1 and July 1 (Compounding Dates), and are treated as if accruing in equal daily

amounts between Compounding Dates, until paid at maturity or upon redemption. Interest shall be computed on the basis of a 360 day year consisting of twelve 30 day months.

The Series C Bonds are subject to redemption at the option of the System from any source, in whole or in part at any time on or after July 1, 2018, at a redemption price equal to the principal amount (in the case of Series C Capital Appreciation Bonds, the accreted amount) of the Series C Bonds, plus accrued interest to the redemption date, and without premium.

In addition, the following Series C Term Bonds are subject to mandatory redemption in part commencing on July 1, 2024 to the extent of the sinking fund requirement for said bonds set forth below at a redemption price equal to 100% of the principal amount thereof plus accrued interest as follows (in thousands):

Redemption period	Subject bonds		Amount
July 1, 2024	Term bonds (final maturity July 1, 2028)	$	18,700
July 1, 2025	Term bonds (final maturity July 1, 2028)		22,000
July 1, 2026	Term bonds (final maturity July 1, 2028)		29,150
July 1, 2027	Term bonds (final maturity July 1, 2028)		36,300
July 1, 2028	Term bonds (final maturity July 1, 2028)		3,850
	Subtotal		110,000
July 1, 2029	Term bonds (final maturity July 1, 2038)		100
July 1, 2030	Term bonds (final maturity July 1, 2038)		540
July 1, 2031	Term bonds (final maturity July 1, 2038)		100
July 1, 2032	Term bonds (final maturity July 1, 2038)		3,420
July 1, 2033	Term bonds (final maturity July 1, 2038)		4,320
July 1, 2034	Term bonds (final maturity July 1, 2038)		100
July 1, 2035	Term bonds (final maturity July 1, 2038)		11,940
July 1, 2036	Term bonds (final maturity July 1, 2038)		2,160
July 1, 2037	Term bonds (final maturity July 1, 2038)		7,920
July 1, 2038	Term bonds (final maturity July 1, 2038)		14,400
	Subtotal		45,000
July 1, 2039	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2040	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2041	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2042	Term bonds (final maturity July 1, 2043)		28,600
July 1, 2043	Term bonds (final maturity July 1, 2043)		28,600
	Subtotal		143,000
Total		$	298,000

The System complied with the sinking fund requirements at June 30, 2014.

Debt service requirements in future years on the System's bonds as of June 30, 2014 are as follows (in thousands):

	Principal	Interest	Total
Year ending June 30:			
2015	$ —	166,519	166,519
2016	—	166,519	166,519
2017	—	166,519	166,519
2018	—	166,519	166,519
2019	—	166,519	166,519
2020–2024	200,000	811,924	1,011,924
2025–2029	387,250	753,416	1,140,666
2030–2034	904,490	716,791	1,621,281
2035–2039	1,045,100	548,184	1,593,284
2040–2044	543,270	285,615	828,885
2045–2049	—	247,568	247,568
2050–2054	—	247,568	247,568
2055–2059	761,000	131,562	892,562
	3,841,110	4,575,223	$ 8,416,333
Less:			
Unaccreted interest	(756,961)		
Unamortized discount	(6,562)		
Total	$ 3,077,587		

Pledge of Employer Contributions Pursuant to Security Agreement – The System entered into a Security Agreement with the Fiscal Agent for the benefit of the bondholders, pursuant to which the System pledged to the Fiscal Agent, and granted the Fiscal Agent a security interest in employer contributions made after January 31, 2008, which was the date of issuance of the first series of bonds, and the funds on deposit with the Fiscal Agent under the various accounts established under the Pension Funding Bond Resolution (the Resolution).

The Resolution and the Security Agreement constitute a contract between the System and the Fiscal Agent, on behalf of the owners of the bonds. The pledge, covenants and agreements of the System set forth in the Resolution and the Security Agreement shall be for the equal benefit, protection and security of the owners of the bonds, regardless of time or times of their issuance or maturity, and shall be of equal rank, without preference, priority or distinction of any of the bonds over any other bond, except as expressly provided in or permitted by the Resolution. Annual employer contributions that are made after January 31, 2008, which was the date of issuance of the first series of bonds, in accordance with the Act and amounts on deposit in the different accounts created pursuant to the Resolution for the benefits of the owners of the bonds, are pledged for annual debt service requirements as established. The pledge is irrevocable so long as any bonds are outstanding under the terms of the Resolution.

(11) Voluntary Termination Benefits

On July 2, 2010, the Commonwealth enacted Act No. 70 establishing a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined. Act No. 70 also established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of creditable services and will consist of monthly benefits ranging from 37.5% to 50% of each employees' monthly salary. Benefits under this program will be paid by the Commonwealth's General Fund, by the public corporations and by the System, covering their respective employees until the plan member reaches the later of age 55 for members under Act No. 447 or age 65 for members under Act No. 1, or the date the plan member would have completed 30 years of service had the member continued employment. In addition, the public corporations and the System, as employers, will also be required to continue making the required employee and employer contributions to the System. The Commonwealth's General Fund will be required to continue making its required employer contributions. The System will be responsible for benefit payments afterwards. As of June 30, 2014, the System has recorded a liability of approximately $14 million for its responsibility as an employer under Act No. 70.

(12) COFINA Bonds

Pursuant to Act No. 96 of June 16th, 2011, during the fiscal year ended June 30, 2011, the System received a special contribution of approximately $163 million from the Puerto Rico Infrastructure Financing Authority, an instrumentality of the Commonwealth. The contribution was invested in bonds issued by the Puerto Rico Sales Tax Financing Corporation (known as COFINA by its Spanish acronym), which provide for a 7% accretion rate and maturity dates between 2043 and 2048. COFINA is a blended component unit of the Commonwealth. As required by Act No. 96 of June 16th, 2011, the System cannot voluntary dispose the COFINA Bonds unless such request has been approved by the GDB. The COFINA Bonds have a fair value of approximately $138 million as of June 30, 2014.

(13) Guarantee Insurance Reserve for Member Loans

The System provides life insurance that guarantees the payment of the outstanding principal balance of mortgage, personal and cultural trip loans in case of death of a plan member. The plan members who obtained these loans from the System pay the coverage in its entirety. The life insurance rates are actuarially determined and do not vary by age, sex, or health status.

(14) Other Postemployment Healthcare Benefits Funded Status and Funding Progress

The System's other postemployment healthcare benefits (OPEB) funded status as of June 30, 2014, the most recent actuarial valuation date, is as follows (dollars in thousands):

Actuarial value of plan assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded ratio	Annual covered payroll	UAAL as a percentage of annual covered payroll
$ —	1,438,475	1,438,475	—%	$ 3,489,096	41.2%

The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

Act No. 3 eliminated the medical insurance plan contribution of $100 per month for future retirees effective July 1, 2013.

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for the current valuation. The liability results as of June 30, 2014 are based on projecting the System obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability gains or losses. In addition, the actuarial cost method was revised in fiscal year 2014 from projected unit credit (used in the actuarial valuations for fiscal year 2013 and before) to the entry age normal method to conform to the requirements of pension benefits. The amortization period for GASB Statement No. 45 has been reduced to the expected future lifetime of current in pay members.

The actuarial valuations used the following actuarial assumptions:

Actuarial cost method	Entry Age Normal
Amortization method	18 years closed (beginning July 1, 2014), level dollar
Remaining amortization period	18 years
Asset valuation method	Not applicable
Actuarial assumptions:	
Investment rate of return	3.10%
Projected salary increases	Not applicable
Projected payroll growth	Not applicable
Inflation	Not applicable
Cost of living adjustment	Not applicable

Actuarial valuations of an ongoing plan involve estimates of the net value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment and mortality. Amounts determined are subject to continuous revision as actual results are compared with past expectations and new estimates are made about the future.

Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. The projection of OPEB for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

The actuarial calculations reflect a long–term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short–term volatility in actuarial accrued liabilities and actuarial value of assets.

The OPEB mortality rate assumptions are the same as that for pension benefits. Refer to note 5.

(15) Contingencies

The System is a defendant in a lawsuit challenging the constitutionality of Act No. 3 and in another lawsuit challenging the constitutionality Act No. 3 and Act No. 32.

In the first lawsuit, the plaintiffs requested the System to honor the participants of an employer of the System, the benefits available to them under Act No. 447 which were affected by Act No. 3 of 2013, with the economic consequences that this would entail. On February 13, 2015, the Puerto Rico Supreme Court denied the plaintiff's recourse. On March 6, 2014, the plaintiffs file an amended complaint, including the System's Board of Trustees as a defendant and including a torts claim against the System's Administration and its Board of Trustees.

In the second lawsuit, the plaintiffs requested the annulment of the provisions of law imposing economic obligations to municipalities in favor of the System. Act No. 3 imposed a $2,000 contribution to all municipalities and public corporations for every retiree as of June 30, 2013 and Act No. 32 imposed an additional uniform contribution according to the corresponding proportion of the employer's contributions. On May 5, 2015, the Puerto Rico First Court of Instance issued a judgment dismissing the case. On July 27, 2015, the plaintiffs filed an appeal at the Puerto Rico Court of Appeals. On January 5, 2016, the Puerto Rico Court of Appeals upheld the decision regarding the dismissal of the case. On April 5, 2016, the plaintiffs filed a Certiorari before the Puerto Rico Supreme Court. The Puerto Rico Supreme Court has yet to issue a ruling regarding this. Although an economic compensation was not requested in this second case, if a ruling declaring invalidity of the questioned articles is made by the Puerto Rico Supreme Court, the System will not receive the payments imposed by Act No. 3 and Act No. 32 to the municipalities and the System would have to refund payments already made under those law provisions.

With respect to these lawsuits, the System, in consultation with legal counsel, has determined that at this stage of the proceedings they cannot offer an opinion as to the probable outcome. Accordingly, management does not consider necessary making any provision in its books for these cases and intends to contest them vigorously.

The System is also a defendant in a lawsuit brought by pensioners of the System. They filed the claim on behalf of the System against the underwriters of certain pension bonds of the System and some of the former members of the Board of Trustees of the System. The complaint requested $800 million in damages resulting from the $3 billion bond issuance in 2008 that, according to the plaintiffs, compromised the solvency of the System. This case is in its initial stages, therefore no provision for liability, if any, which may result upon adjudication of this lawsuit has been recorded by the System.

In addition, the System is a defendant or co-defendant in various lawsuits resulting from the ordinary conduct of its operations. Based on the advice of legal counsel and considering insurance coverages, management is of the opinion that the ultimate liability, if any, will not have a significant effect on the financial status of the System.

(16) Restatement

The following table summarizes the changes to the net position restricted for pensions at the beginning of the year as previously reported by the System (expressed in thousands):

Net position restricted for pensions – July 1, 2013, as previously reported	$	731,342
Impact of GASB Statement No. 65 implementation		(29,981)
Correction of immaterial error		13,696
Net position restricted for pensions – July 1, 2013, as restated and adjusted	$	715,057

As discussed in note 2(i)a, the System adopted GASB Statement No. 65 effective July 1, 2013. At transition, the impact of GASB Statement No. 65 was to decrease the fiduciary net position as of July 1, 2013 by approximately $30 million reflecting the cumulative retrospective effect of derecognizing the debt issuance costs which had previously been deferred in the statement of fiduciary net position.

While preparing the 2014 financial statements, management of the System identified an error whereby the System made benefit payments for JRS retirees. Between 1991 and 2013, the System paid $8.4 million, net, related to JRS retirees. As a result of the incorrect payments made, it is estimated that the System lost $5.2 million of net investment income over time. The total of these amounts, is the amount by which the System's beginning net position restricted for pensions was understated.

(17) Subsequent Events

Subsequent events were evaluated through June 1, 2016, the date the financial statements were available to be issued, to determine if such events should be recognized or disclosed in the 2014 financial statements.

On April 6, 2016, the Governor of Puerto Rico signed into law the Puerto Rico Emergency Moratorium and Rehabilitation Act ("Act No. 21"). Among other objectives, Act No. 21 allows the Governor to declare – at some point in the future – a moratorium on debt service payments and to stay related creditor remedies for a temporary period for the Commonwealth, the GDB, the Economic Development Bank for Puerto Rico, and certain additional government instrumentalities in Puerto Rico, including the System. The temporary period set forth in Act No. 21 lasts until January 31, 2017, with a possible two-month extension in the Governor's discretion. The provisions regarding the moratorium and stay in respect of any obligations owed by the System require executive action of the Governor to become effective. At this time, the Governor has not taken any executive action in respect of the System, and Act No. 21 does not currently affect the System's obligations, including to make debt service payments.

On April 8, 2016, the Governor of Puerto Rico signed an executive order, EO-2016-010 (the "Executive Order"), declaring GDB to be in a state of emergency pursuant to Act No. 21. The Executive Order, in accordance with the emergency powers provided for in Act No. 21, implemented a regulatory framework governing GDB's operations and liquidity, including establishing a procedure with respect to governmental withdrawals, payments, and transfer requests in respect of funds held on deposit at GDB and loan disbursements by GDB. The procedures implemented by the Executive Order may result in restrictions on the ability of the System to withdraw any funds held on deposit at GDB or to receive any disbursements on loans granted by GDB during the period of the Executive Order, which is in effect until June 30, 2016. However, while the Executive Order created a stay on the enforcement of certain financial debt obligations of GDB, it did not impose a moratorium on any financial debt obligation of GDB. The Executive Order did not declare an emergency period for the Commonwealth itself, the System or any other entity, other than GDB.

REQUIRED SUPPLEMENTARY INFORMATION

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Changes in the Employers' Net Pension Liability and Related Ratios – Pension Benefits (Unaudited)

Year Ended June 30, 2014

(Dollars in thousands)

		Amount
Total pension liability:		
Service cost	$	419,183
Interest		1,321,478
Changes in benefit terms		—
Differences between expected and annual experience		53,939
Changes in assumptions		1,198,307
Benefit payments, including refunds of contributions		(1,714,758)
Net change in total pension liability		1,278,149
Total pension liability – beginning		28,941,368
Total pension liability – ending (a)		30,219,517
Plan's fiduciary net position:		
Employer contributions – net of provision		713,813
Member contributions		359,862
Net investment income		225,005
Other income		30,748
Benefit payments, including refunds of member contributions		(1,714,758)
Administrative expenses		(29,530)
Interest on bonds payable		(192,947)
Other expenses		(26,584)
Net change in plan fiduciary net position		(634,391)
Total fiduciary net position – beginning, as restated and adjusted		715,057
Total fiduciary net position – ending (b)		80,666
Employers' net pension liability – ending (a)-(b)	$	30,138,851
Plan's fiduciary net position as a percentage of the total pension liability		0.27%
Covered employee payroll	$	3,489,096
Employers' net pension liability as a percentage of covered employee payroll		863.80%

Note:
Schedule is intended to show information for ten years. Additional years will be displayed as they become available.

See accompanying notes to required supplementary information and independent auditors' report.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of the Employers' Contributions – Pension Benefits (Unaudited)

Last Seven Fiscal Years

(Dollars in thousands)

		2014	2013	2012	2011	2010	2009	2008
Actuarially determined contribution	$	1,822,675	2,192,821	2,019,467	1,734,979	1,459,774	1,258,695	1,191,275
Contributions in relation to annual required contribution (a)		713,813	628,647	589,767	701,399	531,136	595,863	662,275
Contribution deficiency	$	1,108,862	1,564,174	1,429,700	1,033,580	928,638	662,832	529,000
Covered employee payroll (b)	$	3,489,096	3,489,096	3,570,339	3,666,402	3,818,332	4,292,552	N/D
Contribution as a percentage of covered employee payroll (a)/(b)		20.46%	18.02%	16.52%	19.13%	13.91%	13.88%	N/D

N/D = Not determined.

Note:

The contribution requirement to the System is established by law and is not actuarially determined. Schedule is intended to show information for ten years. Additional years will be displayed as they become available.

See accompanying notes to required supplementary information and independent auditors' report.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Investment Return – Pension Benefits (Unaudited)

Year Ended June 30, 2014

Annual money-weighted rate of return, net of investment expenses	11.2%

Note:

Schedule is intended to show information for ten years. Additional years will be displayed as they become available.

See accompanying notes to required supplementary information and independent auditors' report.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Employers' Contributions – OPEB (Unaudited)

(Dollars in thousands)

Fiscal year ended	Annual required contributions	Actual employers' contributions	Percentage of contribution
June 30, 2014 (1)	$ 88,508	$ 102,085	115.3%
June 30, 2013	154,999	91,823	59.2
June 30, 2012	133,654	94,664	70.8
June 30, 2011	129,395	93,851	72.5
June 30, 2010	128,294	88,599	69.1
June 30, 2009	111,683	85,385	76.5
June 30, 2008	110,650	80,019	72.3

(1) The System's annual required contribution for the year ended June 30, 2014 was determined by the actuarial valuation as of June 30,,2013 that was updated to roll forward the funded status to June 30, 2014 and assuming no liability gains or losses.

See accompanying notes to required supplementary information and independent auditors' report.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Schedule of Funding Progress – OPEB (Unaudited)

(Dollars in thousands)

Actuarial valuation date	Actuarial value of plan assets	Actuarial accrued liability (AAL)	Unfunded Actuarial accrued liability (UAAL)	Funded ratio	Annual covered payroll	UAAL percentage of annual covered payroll
June 30, 2014 (1)	$ —	$ 1,438,475	$ 1,438,475	—%	$ 3,489,096	41.2%
June 30, 2013	—	1,482,879	1,482,879	—	3,489,096	42.5
June 30, 2012	—	2,120,970	2,120,970	—	3,570,339	59.4
June 30, 2011	—	1,758,389	1,758,389	—	3,666,402	48.0
June 30, 2010	—	1,699,373	1,699,373	—	3,818,332	44.5
June 30, 2009	—	1,633,159	1,633,159	—	4,292,552	38.0

(1) The System's OPEB funded status as of June 30, 2014 was determined by the actuarial valuation as of June 30, 2013 that was updated to roll forward the funded status to June 30, 2014 and assuming no liability gains or losses.

See accompanying notes to required supplementary information and independent auditors' report.

Changes in Benefits Terms

There have not been any changes in plan provisions since the prior valuation. However, there have been significant changes in recent years as discussed below.

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447, Act No. 1 of February 16, 1990 (Act No. 1), and Act No. 305 of September 24, 1999 (Act No. 305 or System 2000). Act No. 3 of 2013 (Act No. 3) reformed the System by, among other measures, reducing benefits, increasing employee contributions, and, in the case of active employees who were entitled to the defined benefits program, replacing most of the defined benefit elements with a defined contribution structure.

Act No. 3 established a contributory hybrid program (the Contributory Hybrid Program) similar to the System 2000 program that will eventually result in all active and retired members participating in a member-funded hybrid program. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under Act No. 447 and Act No. 1 (defined benefit program), and thereafter, all future benefits will accrue under the defined contribution formula used for the System 2000 program participants. Ceasing future defined benefit accruals under Act 447 and Act 1 and converting to a member-funded hybrid plan will result in lower benefit payments as these tiers wind down, and will make all future employer contributions available to pay benefits and bonds payable debt service.

Participants in the defined benefit program who as of June 30, 2013 were entitled to retire and receive a pension, may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program. Participants who as of June 30, 2013 were not entitled to retire can retire depending on the new age limits defined by the Contributory Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program.

Participants in the System 2000 program who as of June 30, 2013 had reached the age of 60 may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program. Participants in the System 2000 program who as of June 30, 2013 had not reached the age of 60 can retire depending on the new age limits defined by the Contributory Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program.

In addition, Act No. 3 amended the provisions of the different benefit structures under the System including, but not limited to, the following:

- Retirement age – The retirement age for the frozen accrued benefits of Act No. 447 is gradually increased from age 58 to age 61, and from age 60 to age 65 for System 2000 program members, which results in a delay in cash outflow and thus lower cumulative future benefit payments to these members. Reduced early retirement was eliminated for Act No. 1, which also results in a delay in cash outflow. The retirement age for new employees was increased to age 67.
- Member contributions – The prior member contribution rate of 8.275% (varying for some members) is increased to 10% of pay. While this will result in higher hybrid program benefits in the future, it

will provide more assets in the near term that can support current benefit payments and bonds payable debt service.

- Mandated annuitization – System 2000 program notional accounts were available as lump sum payments at termination/retirement. With a full cohort of active System 2000 program members completing careers at roughly the same time that bonds payable principal payments begin, lump sum payments would have had a deleterious effect on the System's assets. Act No. 3 hybrid accounts, which include the System 2000 program accounts, are subject to mandatory annuitization, which will benefit the System on a cash flow basis by stretching out payments over time, thus providing the System "catch-up" time. The System has the authority for determining the annuitization factors and for updating the factors in future years.
- Survivor benefits – Act No. 447 and Act No. 1 offered survivor benefits at no cost to the retiree. For future retirees, the defined benefit portion of the Act No. 447 or Act No. 1 frozen annuity and the hybrid program Act No. 3 annuity will be subject to an actuarially determined reduction if the member elects an annuity with a survivor benefit, resulting in lower future cash outflow.
- The occupational death benefit and the one year of salary death benefit were eliminated for Act No. 447 and Act No. 1 members, resulting in lower future cash outflow.
- Disability benefits, other than those provided under Law No. 127, were eliminated, resulting in lower future cash outflow. (A member who becomes disabled may receive their hybrid account balance and their accrued benefit if applicable under Act No. 447 or Act No. 1).
- Special law benefits are reduced for current retirees and eliminated for future retirees. The Christmas bonus payable to current retirees was reduced from $600 to $200. The summer bonus was eliminated. The employers will continue making contributions to the System as if all special law benefits were still in place for current and future Act No. 447 and Act No. 1 retirees, which will result in additional cash that can be used for benefit payments and bonds payable debt service.
- Minimum benefits – The minimum pension payable was increased from $400 to $500 per month for current retirees only.
- Merit Annuity – The "Merit Annuity" available to participants who joined the System prior to April 1, 1990 was eliminated.

Changes in Assumptions

Actuarial assumptions are revised periodically to more closely reflect actual, as well as anticipated future experience.

Due to the change in the census collection date to the beginning of the fiscal year, rather than the end of the fiscal year, demographic gain/loss during the year is limited to the difference between actual and expected benefit payments, which arise from differences in termination and retirement activity and mortality versus expectations. In fiscal year 2014, this difference resulted in a loss of $54 million.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO

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The asset basis for the date of depletion projection is the System's fiduciary net position (the gross assets plus deferred outflows of resources less the gross liabilities, including the senior pension funding bonds payable, plus deferred inflows of resources). On this basis, the System's fiduciary net position was estimated to be exhausted in the fiscal year 2015.

In addition, the date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No. 32 because of actual fiscal and budgetary financial difficulties with continued budget deficits and liquidity risks of the Commonwealth and the municipalities and in the event that their financial condition do not improve in the near term.

The System's fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the tax free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability.

The discount rate used to determine the annual required contribution decreased from 6.40% at June 30, 2013 to 4.29% at June 30, 2014. Under GASB Statements No. 25 and No. 27, the investment return assumption was used to discount all projected Basic System Pension Benefits and System Administered Pension Benefits to determine the Actuarial Accrued Liability. Under GASB Statement No. 67, the investment return assumption is an input that is used in the calculation of the single equivalent interest rate that is used to discount these benefits to determine the Total Pension Liability. For fiscal years 2008 to 2010 and for fiscal years 2011 and 2012, the discount rates were 7.50%, 6.40% and 6.00%, respectively.

Also, the fiscal year valuation reflects a salary freeze until July 1, 2017 due to Act No. 66 and the current economic conditions in Puerto Rico.

Changes in Actuarial Methods since the prior Valuation

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2013 census data used in the prior valuation is also used as the July 1, 2013 census data for the current valuation. The liability results as of June 30, 2014 are based on projecting the System obligations determined as of the census data collection date of July 1, 2013 for one year, using roll-forward methods and assuming no liability gains or losses.

The June 30, 2014, actuarial valuation reflects an increase of $1,198 million in the total pension liability as a result of the changes in assumptions as required by GASB Statement No. 67.

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Method and Assumptions Used in Calculation of the System's Annual Required Contributions

Unless otherwise noted above, the following actuarial methods and assumptions were used to determine contribution rates reported in the Pension Benefits Schedule of the Employers' Contributions:

Inflation	2.50%
Investment rate of return	6.75%, net of investment expenses, including inflation
Municipal bond index	4.29%, as per Bond Buyer General Obligation 20 – Bond Municipal Bond Index
Discount rate	4.29%
Projected salary increases	3.00% per year. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66 and the current general economy.
Mortality	Pre-retirement Mortality: For general employees not covered under Act No. 127, RP-2000 Employee Mortality Rates for males and females projected on a generational basis using Scale AA. For members covered under Act No. 127, RP-2000 Employee Mortality Rates with blue collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational for members covered under Act No. 127. Post-retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females. The rates are projected on a generational basis starting in 1994 using Scale AA. As a generational table, it reflects mortality improvements both before and after the measurement date. Post-retirement Disabled Mortality: Rates which vary by gender are assumed for disabled retirees based on a study of plan's experience from 2007 to 2012 equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. No provision was made for future mortality improvement for disabled retirees.